

2011  
Higher School Certificate  
Trial Examination

# 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 2–9**

**20 marks**

Attempt Questions 1–20

Allow about 35 minutes for this section

**Section II – Pages 10–17**

**40 marks**

Attempt Questions 21–24

Allow about 1 hour and 15 minutes for this section

**Section III – Pages 18–19**

**20 marks**

Attempt either Question 25 or Question 26

Allow about 35 minutes for this section

**Section IV – Page 20**

**20 marks**

Attempt EITHER Question 27 or Question 28

Allow about 35 minutes for this section

**Section I****20 marks****Attempt Questions 1–20****Allow about 35 minutes for this section**

Select the alternative A, B, C or D that best answers the question and indicate your choice with a cross (X) in the appropriate space on the grid below.

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	A	B	C	D
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1 What will be the likely impact on the Australian economy if the Federal Government reduced the size of the budget deficit during the early phase of a recovery?

(A) An increase in economic growth  
(B) An increase in the level of employment  
(C) A decrease in the level of funds available to the private sector  
(D) A decrease in the discretionary spending on public infrastructure projects

2 Which of the following is included as a debit on the financial account of the balance of payments?

(A) Expenditure by Australian residents on imported goods  
(B) Payment of dividends to foreign investors  
(C) Australians investing in overseas projects  
(D) Payment of overseas pensions to foreign citizens

3 The following table shows selected data for an economy.

Year	Gini co-efficient	Nominal GDP (\$m)	Consumer Index Price
1	0.310	\$450m	100
2	0.313	\$550m	110
3	0.318	\$700m	120

Which of the following statements is correct?

(A) From Year 1 to Year 3 the distribution of income is more equitable and real GDP has increased.

(B) From Year 1 to Year 3 the distribution of income is more equitable and real GDP has decreased.

(C) From Year 1 to Year 3 the distribution of income is more unequal and real GDP has decreased.

(D) From Year 1 to Year 3 the distribution of income is more unequal and real GDP has increased.

4 What is the most likely cause of an increase in petrol prices?

(A) Disruptions to oil production in oil exporting countries  
(B) Oil exporting countries expanding oil supply to world markets  
(C) Cuts in excise duty on fuel imposed by the federal government  
(D) Decreased world demand for oil

5 Which of the following measures is likely to generate a more equal distribution of income among individuals in Australia?

(A) Increased minimum wages  
(B) A decrease in the top rate of marginal income tax  
(C) Decreased welfare payments  
(D) An increase in the rate of Goods and Services Tax

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

Injection/Leakage	\$ millions
Exports	90
Taxation	50
Imports	?
Savings	240
Investment	200
Government expenditure	100

What is the level of imports for this economy?

(A) \$90m  
(B) \$200m  
(C) \$100m  
(D) \$290m

7 Which of the following macroeconomic policies could be used to increase the level of aggregate demand in the Australian economy?

(A) An increase in the size of the budget surplus  
(B) The buying of government securities by the Reserve Bank  
(C) Labour market reforms to lift the level of productivity and output  
(D) A freeze on public sector wage claims

8 Which of the following economic goals would indicate the successful implementation of microeconomic reforms by the Australian government?

- (A) An increase in the current account deficit and an increase in the level of employment
- (B) An increase in inflation and an increase in the level of employment
- (C) A decrease in the current account deficit and a decrease in inflation
- (D) An increase in economic growth and an increase in the current account deficit

9 The following table shows selected data for an economy.

Change in autonomous investment ( $\Delta I$ )	\$300m
Change in the equilibrium level of income ( $\Delta Y$ )	\$1500m

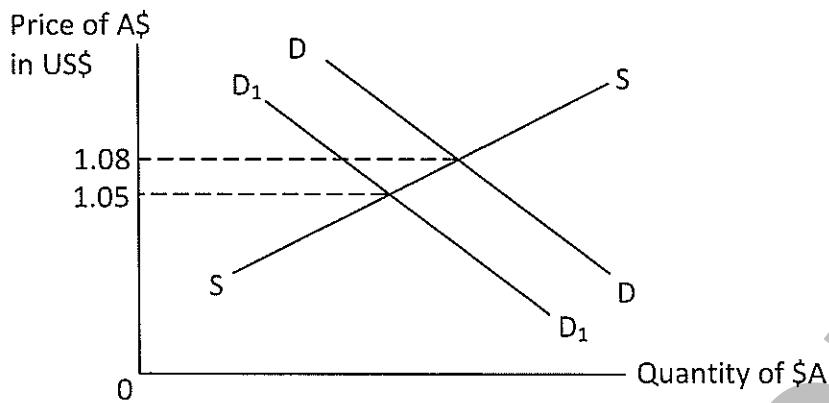
What is the value of the marginal propensity to consume (MPC) which determined the new equilibrium level of national income?

- (A) 5.0
- (B) 0.8
- (C) 0.2
- (D) \$1200m

10 Where would the payment by British Petroleum in the UK to BHP Billiton in Australia for new gas leases appear in the Australian Balance of Payments?

- (A) A debit in the Capital and Financial Account
- (B) A debit in the Primary Income section of the Current Account
- (C) A debit in the Goods and Services section of the Current Account
- (D) A credit in the Capital and Financial Account

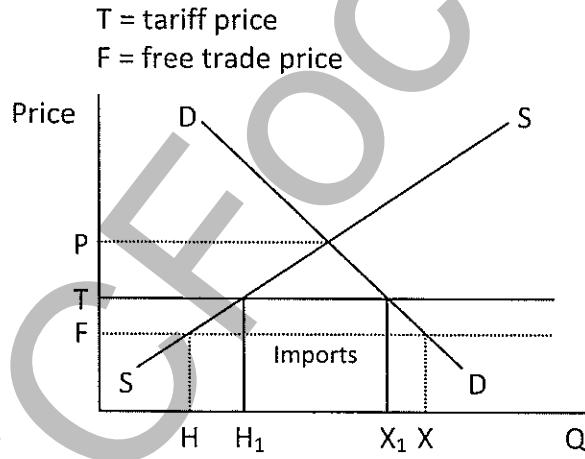
11 The following diagram shows the foreign exchange market for Australian dollars.



Which of the following could have caused the fall in the value of the Australian dollar?

- (A) Lower global commodity demand
- (B) Higher interest rates in Australia
- (C) Positive expectations about the Australian dollar
- (D) Reserve Bank purchases of Australian dollars in the foreign exchange market

12 The following diagram shows the effect of a tariff.



What effect does the imposition of the tariff have on domestic supply?

- (A) Domestic supply falls from HX to H<sub>1</sub>X<sub>1</sub>.
- (B) Domestic supply rises from the free trade price to the tariff price.
- (C) Domestic supply is HX.
- (D) Domestic supply rises from H to H<sub>1</sub>.

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

- (A) Changes in taxation rates by the government in its budget
- (B) Increases in welfare payments due to poor economic growth
- (C) Decreases in taxation revenue due to strong economic growth
- (D) A change in the budget outcome from a deficit to surplus

14 The following table shows the Consumer Price Index (CPI) for an economy.

Year	CPI
1	100
2	103.9
3	108.4
4	111.5

What is the inflation rate for Year 4?

- (A) 11.5%
- (B) 2.9%
- (C) 4.0%
- (D) 3.5%

15 Which of the following international organisations lends funds to developing countries for economic development?

- (A) The World Bank
- (B) The International Monetary Fund (IMF)
- (C) The Group of Seven (G7)
- (D) The Asia Pacific Economic Co-operation forum (APEC)

16 What is an advantage of international economic integration?

- (A) A greater role for transnational corporations in economic policy
- (B) More widespread use of tariffs and subsidies in world trade
- (C) Greater economies of scale in global production
- (D) Less emphasis on bilateral and multilateral trade agreements

17 The following table shows balance of payments data for an economy with a floating exchange rate.

Exports of goods	\$500 billion
Imports of goods	\$600 billion
Net services	-\$100 billion
Net primary income	-\$200 billion
Net secondary income	\$15 billion
Capital account	\$85 billion
Financial account	\$285 billion
Reserve assets	\$15 billion

According to the information in the table which of the following statements is correct for this economy?

(A) The goods and services balance is a surplus of \$1000 billion.

(B) The current account is in deficit of \$385 billion.

(C) The balance on capital and financial account is a surplus of \$370 billion.

(D) The balance of payments is in deficit by \$1200 billion.

18 What would be two indicators of an easing in monetary policy in Australia?

(A) Lower interest rates and selling of government securities

(B) Lower interest rates and lower tax rates

(C) Lower interest rates and the purchasing of government securities

(D) Higher interest rates and the purchasing of government securities

19 The following labour force data is for a hypothetical economy.

Working Age of the Population	Full Time Employed	Part Time Employed	Unemployed
18,000,000	7,800,000	3,300,000	600,000

What is the participation rate for this economy?

(A) 61.6%

(B) 5.4%

(C) 6.4%

(D) 65.0%

20 Which of the following are indicators of an improvement in the quality of life in a developing country?

- (A) Rising levels of income, environmental pollution and crime
- (B) Rising levels of literacy, malnutrition and access to clean water
- (C) Rising levels of life expectancy, literacy and income
- (D) Rising levels of exports, foreign debt and political stability

## 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.

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### Question 21 (10 marks)

Marks

The table shows selected economic data for the Australian economy.

Time period	Exchange rate of the \$A against the \$US	Trade Weighted Index
May 2010	0.85	67.7
May 2011	1.07	77.8

(a) Outline TWO measures of determining Australia's exchange rate.

2

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(b) Outline TWO factors which may have contributed to the change in the value of the Australian dollar against the \$US between May 2010 and May 2011.

2

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.....

Question 21 continues on the next page

STUDENT NUMBER/NAME: .....

Question 21 (continued)

## Marks

(c) Explain how the Reserve Bank could intervene in the foreign exchange market to improve Australia's international competitiveness.

2

(d) Analyse the impact of TWO changes in the components of the balance of payments on the value of the Australian dollar and the Australian Government's goal of external stability.

4

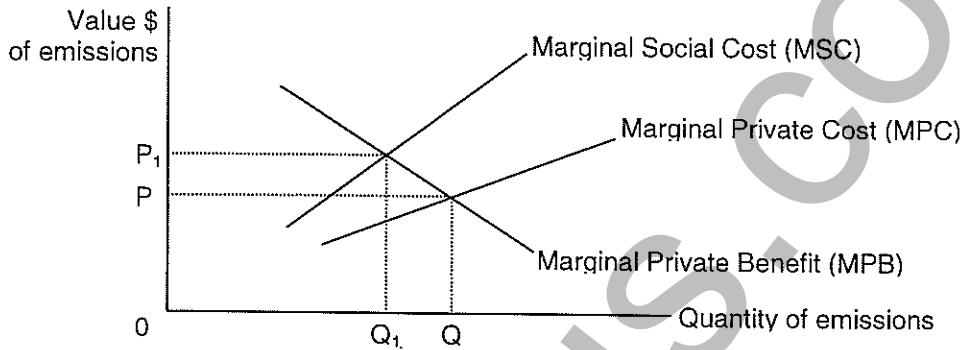
**End of Question 21**

**Question 22 (10 marks)**

### Marks

(a) Why is the emission of carbon by industry, considered to be a negative externality in production?

(b) The following diagram relates to the emissions of carbon by industry in Australia.



Explain what is meant by the MPB, MPC and MSC curves in the diagram and indicate why there is market failure in the production process.

**More space for Question 22 (b) on the next page**

STUDENT NUMBER/NAME: .....

Question 22 (continued)

## Marks

(c) With reference to the diagram, explain how the Government could use a policy to correct market failure in the emissions of carbon and discuss TWO economic impacts on Australia of this change in Government policy.

4

**End of Question 22**

“Both the Reserve Bank and the Government agree on the importance of low inflation and low inflation expectations. These assist businesses in making sound investment decisions, underpin the creation of jobs, protect the savings of Australians and preserve the value of the currency. In pursuing the goal of medium-term price stability, both the Reserve Bank and the Government agree on the objective of keeping consumer price inflation between 2 and 3 percent, on average, over the cycle.”

Source: Reserve Bank of Australia (2010), *Statement on the Conduct of Monetary Policy*.

(a) Define what is meant by *monetary policy*.

1

(b) Outline the objectives of monetary policy.

2

(c) Explain how the Reserve Bank uses an inflation target to conduct monetary policy.

3

Question 23 (continued)

## Marks

(d) Explain the impact of higher interest rates on the Australian economy.

4

**End of Question 23**

**Question 24 (10 marks)**

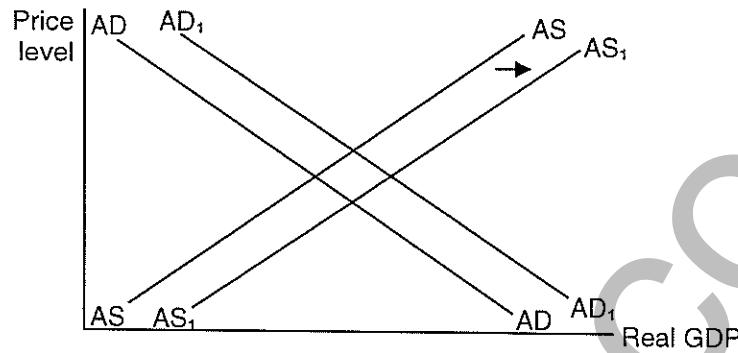
## Marks

(a) Define what is meant by *microeconomic policy*.

1

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(b) The graph shows shifts in both the aggregate demand and aggregate supply curves.



Outline ONE microeconomic policy action likely to cause the shift in the supply curve.

1

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(c) Explain the rationale for microeconomic policies in terms of shifts in aggregate supply and economic efficiency.

4

**More space for Question 24 (c) on the next page**

STUDENT NUMBER/NAME: .....

Question 24 (continued)

## Marks

(d) Examine the role of microeconomic policies in encouraging structural change in the Australian economy.

4

**End of Question 24**

### 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)

Explain the use of macroeconomic and microeconomic policies by the Australian Government to achieve the objectives of price stability and full employment.

“As Australia takes advantage of its new opportunities and manages the process of structural change, the task for the Reserve Bank of Australia (RBA) is to keep inflation low and stable. By doing this, we can help promote sustainable growth in jobs as well as economic and financial stability. Over the past 20 years, low inflation has been a key ingredient to Australia’s economic success and maintaining that record will help us meet the challenges that lie ahead.”

Source: Philip Lowe, Assistant Governor, Reserve Bank of Australia, *Inflation: The Recent Past and the Future*, 24<sup>th</sup> June 2011.

“The medium-term outlook for the economy continues to be dominated by the expected build-up in mining investment and the boost to incomes from the high terms of trade. Providing a partial offset to these factors, monetary policy is mildly restrictive, the exchange rate has appreciated substantially and fiscal policy will be contractionary over the next couple of years. Nevertheless, inflationary pressures are expected to build gradually over the forecast period as spare capacity is absorbed and the labour market continues to tighten.”

Source: Reserve Bank of Australia (2011), *Statement on Monetary Policy*, May.

OR

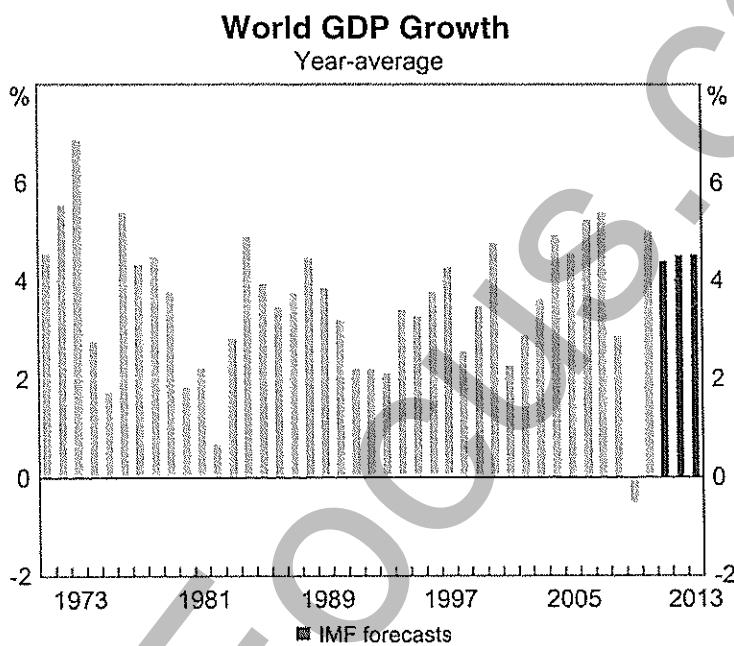
Please turn over

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 (20 marks)

Explain the impact of changes in the global economy on Australia's trade and financial flows.



Source: Reserve Bank of Australia (2011), *Statement on Monetary Policy*, May.

"The large increases in bulk commodity contract prices have significantly boosted Australia's export revenues, with the trade balance in the December quarter recording its largest surplus as a share of GDP since the early 1970s. The current account deficit in the past three quarters averaged 1.8 per cent of GDP, well below the average deficit of 4.5% over the preceding decade.

The significant increase in contract prices has also contributed to an estimated increase of around 20% in Australia's terms of trade over the year to the March quarter, taking them to around 95% above the average of the 1990s. The large rise in the terms of trade over recent years has led to a significant appreciation of the exchange rate, which in real terms is around the levels of the mid 1970s.

Source: Reserve Bank of Australia (2011), *Statement on Monetary Policy*, May.

## Section IV

20 marks

Attempt either Question 27 or Question 28

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.

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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

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### Question 27 (20 marks)

Discuss the effects of labour market policy responses designed to encourage employment, education and training in the Australian labour market.

OR

### Question 28 (20 marks)

Discuss the influence of globalisation on an economy other than Australia and evaluate the strategies used in this economy to promote economic growth and development.

End of paper

**NSW INDEPENDENT TRIAL EXAMS – 2011**  
**ECONOMICS TRIAL HSC EXAMINATION**  
**MARKING GUIDELINES**

**Section I**

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

**Section II**

**Question 21(a) Outcomes assessed: H1, H4**

Criteria	Marks
• Sketches in general terms TWO measures of determining Australia's exchange rate	2
• Sketches in general terms ONE measure of determining Australia's exchange rate OR identifies rather than outlines two measures of determining Australia's exchange rate	1

*Answers could include:*

- The Australian dollar is measured separately against most major currencies in the world through bilateral rates such as the \$US/\$A bilateral rate.
- The Australian dollar is measured against the Trade Weighted Index, which is the average exchange rate for a basket of currencies of Australia's major trading partners, weighted according to their importance in Australia's trade.

**Question 21(b) Outcomes assessed: H1, H7**

Criteria	Marks
• Sketches in general terms TWO factors which may have contributed to the change in the value of the Australian dollar against the \$US from May 2010 to May 2011	2
• Sketches in general terms ONE factor which may have contributed to the change in the value of the Australian dollar against the \$US from May 2010 to May 2011 OR identifies rather than outlines two factors	1

*Answers could include:*

- An increase in the demand for Australian exports, for example iron ore and coal. This may also be linked to a rising terms of trade for Australia.
- A more favourable interest rate differential in Australia. This would encourage overseas investment into Australia, therefore increasing the demand for the Australian dollar.
- Speculative factors. The demand for the Australian dollar increases because of the expectation that the Australian dollar will rise in value on the foreign exchange market in the future.
- Increased demand for Australian assets such as shares, bonds and real estate, which may be generating high returns for foreign investors.

**Question 21(c) Outcomes assessed: H1, H2, H6**

Criteria	Marks
• Relates cause and effect in showing how the Reserve Bank can intervene in the foreign exchange market AND why it may improve Australia's international competitiveness	2
• Shows how the Reserve Bank can intervene in the foreign exchange OR has a limited understanding of why a decrease in the value of the Australian dollar may improve Australia's international competitiveness	1

*Answers could include:* The Reserve Bank would sell Australian dollars and purchase foreign currency in the foreign exchange market. This would increase the supply of Australian dollars and would lead to a depreciation of the currency. This action by the Reserve Bank would improve Australia's international competitiveness because export prices would be lower and import prices higher, allowing domestic firms to improve their competitive position through cheaper exports and import competing goods and services.

<ul style="list-style-type: none"> <li>Draws out and makes the implications clear between TWO changes in the components of the balance of payments on the value of the Australian dollar and the Australian Government's goal of external stability</li> </ul>	3-4
<ul style="list-style-type: none"> <li>Makes implication(s) between ONE change in the components of the balance of payments on the value of the Australian dollar and the Australian Government's goal of external stability</li> </ul>	1-2
OR	
<ul style="list-style-type: none"> <li>Provides a general description of the components of the balance of payments but doesn't provide a link between the impact on the value of the Australian dollar and the Australian Government's goal of external stability</li> </ul>	

*Answers could include:*

- The Australian Government's goal of external stability is measured by looking at a range of economic indicators. These indicators include the size of the current account deficit (CAD) as a percentage of GDP, net foreign debt (NFD) as a percentage of GDP, the debt servicing ratio, the terms of trade and the value of the Australian dollar over time.
- An improvement in the goods balance (the difference between export receipts and import payments) on the current account of the balance of payments will contribute towards reducing the size of the CAD. Assuming the improvement has been due to an increase in export income, this will lead to an increase in demand (an appreciation) for the Australian dollar. A smaller CAD as a percentage of GDP will show greater stability in Australia's external accounts.
- An increase in the financial account surplus on the balance of payments brought about by higher interest rates in Australia compared to other countries, leads to an increase in investment into Australia and an increased demand for the Australian dollar (an appreciation). The repayment of the interest, profit and dividends, will increase the net primary income account on the current account, which will lead to a deterioration in Australia's external accounts.
- An increase in the net primary income deficit in the current account may be due to increased remittances of profits, interest and dividends to overseas lenders to service overseas debt and equity borrowings. A higher net primary income deficit will increase the size of the current account deficit and will reduce the ability of the Australian Government to achieve external stability if the CAD is increasing as a percentage of GDP. A higher CAD, in turn, could lead to a depreciation in the exchange rate, making exports cheaper but imports dearer, therefore increasing imported inflation.

**Question 22(a) Outcomes assessed: H1**

Criteria	Marks
<ul style="list-style-type: none"> <li>Correctly explains why the emission of carbon by industry is considered to be a negative externality in production because it has negative consequences on an unwilling third party such as society</li> </ul>	2
<ul style="list-style-type: none"> <li>Attempts to explain why the emission of carbon by industry is considered to be a negative externality in production, but does not indicate an affected third party such as society at large</li> </ul>	1

*Answers could include:* A negative externality occurs when a cost is imposed on an unwilling third party by a private consumption or production activity. Society or the community at large is affected in a negative way by the impacts caused by industry carbon emissions such as health problems, degradation of the environment and acceleration in the rates of global warming and climate change.

**Question 22(b) Outcomes assessed: H1, H4, H9**

Criteria	Marks
<ul style="list-style-type: none"> <li>Correctly states that: <ul style="list-style-type: none"> <li>Marginal Private Cost is the cost to industry of production.</li> <li>Marginal Private Benefit is the demand for the product which gives the consumer satisfaction.</li> <li>Marginal Social Cost is the cost (of a negative externality) borne by society which is not factored into the price of the product and also indicates that there is market failure in the production process as the product is oversupplied and underpriced.</li> </ul> </li> </ul>	4

*Question 22(b) continues on the next page*

*Question 22(b) continued*

<ul style="list-style-type: none"> <li>Correctly states the answer to some but not all of the above, such as correct definitions of the MPC, MPB and MSC curves, but no mention of market failure. Alternatively a correct explanation of market failure, but not the correct definitions of the MPB, MPC and MSC curves</li> </ul>	1–3
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*Answers could include:* The Marginal Private Benefit Curve measures the utility or satisfaction of consumers from consuming a good or service, whereas the Marginal Private Cost curve reflects the private costs of producers in supplying a good or service in a market. In the case of a negative externality in production, the real cost of production is the Marginal Social Cost which reflects the MPC and the cost of an externality such as carbon emissions to society.

Market failure arises in such cases because the allocation of resources in production is inefficient since the good or service produced is oversupplied and underpriced in the market and does not reflect the social costs imposed on society through excess carbon emissions of industry. In such cases of market failure the government may intervene through taxes, regulations or market based incentives to compel industry to pay for carbon emissions and reduce these emissions over time.

*Question 22(c) Outcomes assessed: H1, H7*

Criteria	Marks
<ul style="list-style-type: none"> <li>Correctly explains how the government could attempt to correct this market failure by regulation through a carbon tax or emissions target or use of a market based instrument such as an emissions trading scheme. Such policies would shift the MPC curve to the left and raise the cost to producers of carbon emissions</li> </ul>	3–4
<ul style="list-style-type: none"> <li>Correctly explains TWO economic impacts of this change in policy on Australia such as a loss of production and employment, and higher prices, but also a possible increase in investment in cleaner energy sources and technologies and a reduction in carbon emissions</li> </ul>	2
<ul style="list-style-type: none"> <li>Correctly explains how the government could attempt to correct this market failure, but does not relate this to the diagram</li> </ul> <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> <li>Correctly explains TWO economic impacts to Australia of this change of government policy such as higher prices to consumers and losses in production AND/OR employment</li> </ul>	
<ul style="list-style-type: none"> <li>Correctly explains ONE economic impact to Australia of this change of government policy</li> </ul>	1

*Answers could include:* The government may impose a carbon tax or pollution charge on the production of carbon emissions. The tax causes industry to internalise the externality and this shifts the Marginal Private Cost curve to the left which reduces production and increases price, thus reflecting Marginal Social Cost. Other government policy instruments could be used such as setting an emissions target at  $Q_1$  and compelling producers to buy emissions permits to emit carbon. This would also lead to a shift in the MPC curve to the left and force producers to either invest in new technologies to reduce emissions or buy permits to maintain their level of carbon emissions. A third policy would be to introduce an emissions trading scheme where the emission target is set at  $Q_1$  and producers would set the price of carbon emissions by competing for emissions permits.

A number of economic impacts on Australia could be discussed such as lower production of carbon emitting industries, which in turn could lead to lower employment levels and international competitiveness. Other impacts could be increased incentives to reduce carbon emissions by investing in non polluting energies and technologies and the development of an international carbon market which could lead to lower global carbon emissions.

*Question 23(a) Outcomes assessed: H1*

Criteria	Marks
<ul style="list-style-type: none"> <li>States the correct meaning and identifies the essential features of <i>monetary policy</i></li> </ul>	1

*Answers could include:* Monetary policy refers to actions by the Reserve Bank of Australia to influence the availability and cost of credit in Australia. The Reserve Bank conducts monetary policy on behalf of the Australian government for macroeconomic stabilisation through changes in interest rates.

<ul style="list-style-type: none"> <li>Sketches in general terms the THREE main objectives of monetary policy which are price stability, full employment and economic growth and prosperity</li> </ul>	2
<ul style="list-style-type: none"> <li>Sketches in general terms ONE or TWO of the three objectives of monetary policy such as price stability and full employment, or price stability and economic growth, or full employment and economic growth</li> </ul>	1

*Answers could include:*

- The objective of price stability is to maintain low inflation and inflationary expectations over the economic cycle by achieving the inflation target.
- The objective of full employment is to secure full employment of the economy's resources including full employment of labour.
- The objective of economic growth is to achieve sustainable economic growth which leads to rising levels of employment accompanied by low inflation and external stability.

**Question 23(c) Outcomes assessed: H1, H2, H5, H6**

Criteria	Marks
<ul style="list-style-type: none"> <li>Relates cause and effect in showing how the Reserve Bank uses an inflation target of 2% to 3% consumer price inflation over the cycle to conduct monetary policy. The inflation target acts as a performance benchmark for the conduct of monetary policy and is a precondition for the achievement of the goals of monetary policy</li> </ul>	3
<ul style="list-style-type: none"> <li>Shows some understanding of the importance of the inflation target but does not relate this to its use as a performance benchmark for the conduct of monetary policy</li> </ul>	1-2

*Answers could include:* The Reserve Bank has used an inflation target of 2% to 3% consumer price inflation to conduct monetary policy since 1993. Achieving the inflation target on average over the economic cycle is a precondition for achieving the other goals of monetary policy which are economic growth and full employment. If inflation is increasing during a boom and outside the target band, the Reserve Bank would raise interest rates to reduce aggregate demand and spending and inflationary expectations, until inflation was within the target band of 2% to 3%. Conversely, if inflation pressures were contained and the economy was operating below capacity, the Reserve Bank may reduce interest rates to stimulate growth and employment. In this way the inflation target is used to conduct monetary policy (through changes in interest rates) in keeping the economy on a sustainable growth path.

**Question 23(d) Outcomes assessed: H1, H2, H6, H7**

Criteria	Marks
<ul style="list-style-type: none"> <li>Relates the cause and effect of the impact of higher interest rates on the Australian economy. These would include lower consumption and investment spending which would reduce the rates of economic growth and inflation. Overall, the impact would be to reduce aggregate demand and the rate of economic growth, as well as future rates of inflation</li> </ul>	3-4
<ul style="list-style-type: none"> <li>Identifies rather than explains the impact of higher interest rates on the Australian economy, such as lower consumption and investment or higher levels of saving</li> </ul>	1-2

*Answers could include:*

- The impact of higher interest rates on the Australian economy would be felt by the household, firms and overseas sectors. Households would reduce their credit borrowings and consumption spending and have an increased incentive to save and reduce their levels of debt. Firms would be discouraged from borrowing for investment purposes and may also reduce their gearing levels. Lower levels of consumption and investment will lead to lower aggregate demand and rates of economic growth and future inflation.
- An impact of higher interest rates in the Australian economy may be to encourage increased foreign investment into the economy as returns on investment projects are higher. Increased foreign investment or capital inflow will increase the demand for Australian dollars in the foreign exchange market and may lead to an appreciation of the exchange rate. Such an appreciation would reduce international competitiveness through higher export prices, but also lower import prices, helping to reduce imported inflation.

**Question 24(a) Outcomes assessed: H1**

Criteria	Marks
• Correctly states what is meant by the term <i>microeconomic policy</i>	1

*Answers could include:* Microeconomic policy involves a range of reforms/policies to improve resource allocation and productivity across a number of sectors of the Australian economy and particular industries. It involves the strengthening of competition and incentives to increase productivity and efficiency in various industries and markets. Successful microeconomic reforms help to promote economic growth, employment, exports and rising standards of living in the community through higher incomes and lower prices.

**Question 24(b) Outcomes assessed: H1, H5, H6**

Criteria	Marks
• Sketches in general terms ONE microeconomic policy action likely to cause the rightward shift of the aggregate supply curve	1

*Answers could include:* Examples of microeconomic policy in Australia that could be responsible for increasing the level of aggregate supply in the economy, thereby moving the aggregate supply curve to the right, include: competition policy, tariff reform, taxation reform, labour market reform and reform in infrastructure such as transport and communications industries.

Other reforms that could be mentioned are the deregulation of certain industries such as the financial sector, domestic aviation and telecommunications to make them more competitive and efficient. Another area of microeconomic policy has been the improvement in efficiency of Public Trading Enterprises (PTEs) through the policies of deregulation, commercialisation and privatisation.

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

Criteria	Marks
• Demonstrates a clear, concise and balanced understanding of the role of microeconomic policies in facilitating increased levels of aggregate supply and improved levels of economic efficiency	4
• Demonstrates a sound understanding of the role of microeconomic policies in facilitating increased levels of aggregate supply and improved levels of economic efficiency	3
• Sketches in general terms the role of microeconomic policies in facilitating increased levels of aggregate supply and improved levels of economic efficiency	2
• Lists some of the positive ways that microeconomic policies impact on the economy	1

*Answers could include:* The main effect of microeconomic policy is to shift the long run aggregate supply curve of the Australian economy to the right, which represents an expansion in long term productive capacity. If microeconomic policy is successful, more output (i.e. real goods and services) can be produced with the same level of inputs. As a result, real GDP increases (i.e. the rate of economic growth) and the price level will fall over the long run. This helps to sustain economic growth because as output increases in real terms there is no accompanying rise in the level of inflation.

The objective of microeconomic reform is to improve the efficient operation of the economy. Efficiency is generally interpreted in terms of productivity or the value of output that is produced with a given quantity of inputs. Microeconomic reform will result in an increase in productivity where:

- It raises the quality of inputs being applied in production; or
- It improves the allocation of inputs between production activities.

Where either of these conditions holds there may be a one-off increase in the level of productivity, or an increase in the rate of growth of productivity in the economy. Increases in the quality of inputs may occur through a rise in the productive capacity of those inputs, or an increase in the intensity with which the inputs are applied. For example in the case of labour inputs supplied by workers, the value of output produced by an hour of labour from a worker will increase with the skill of that worker (productive capacity), and with the effort of the worker (intensity of application).

*Question 24(c) continues on the next page*

In general terms, microeconomic policies are linked to three main types of efficiency gains:

- Allocative efficiency – where firms set prices based on the marginal cost of production and resources will be allocated according to consumer preferences for goods and services
- Technical or productive efficiency – where firms produce output using the least cost combination of resources
- Dynamic efficiency – where firms adapt to changing economic circumstances by using modern cost reducing technology

**Question 24(d) Outcomes assessed: H1, H2, H5, H6, H7**

Criteria	Marks
• Clearly and concisely inquires into the role of microeconomic policies in encouraging structural change in the Australian economy	4
• Inquires into the role of microeconomic policies in encouraging structural change in the Australian economy	3
• Sketches in general terms the role of microeconomic policies in encouraging structural change in the Australian economy	2
• Lists some of the ways that microeconomic policies encourage structural change in the Australian economy	1

*Answers could include:* Microeconomic policies have a key role to play in fostering structural change across the broad range of agricultural, manufacturing and service based industries, which has delivered substantial gains in productivity and efficiency. Data sourced from the Australian Productivity Commission shows that as a result of a range of microeconomic policy reforms introduced in the Australian economy during the 1980s and 1990s, there was an upsurge in productivity growth from the mid 1990s onwards. Following the Hilmer reforms in the early 1990s, multi-factor productivity, which had previously been growing at around 1% per year, accelerated to 2.4% in the mid 1990s. More specifically over the period from 1964–65 to 1993–94, multi-factor productivity growth was 1.2% per annum, but from 1993–94 to 1997–98 the rate of growth was 2.4%. Multi-factor productivity growth can be thought of as a measure of growth in output that adjusts for increases in labour and capital used in production. However, after 1998 multi-factor productivity growth slowed and by the early 2000s it had returned to its previous long run average rate.

Microeconomic policy has been crucial for modernising the management practices of Australian firms. Management practices and work arrangements are an important driver of productivity at the firm level. Significant change took place in these practices as competition created pressures to adjust the organisation of labour. For example, in the case of Australia's automotive industry, increasing competitive pressures strongly influenced changes to increase flexibility in workplace arrangements. These changes included the introduction of career paths, multi-skilling, greater employee involvement in production decisions and better industrial relations systems. These changes were helped by reforms in the industrial relations system and the introduction of enterprise bargaining.

As a result of increased competition from imports, stimulated in part by tariff reductions, local businesses have been required to compete with successful, efficient and overseas firms. Subsequently the local firms have introduced strategies such as benchmarking, quick response production, and just-in-time inventory systems. For example, additional cost pressures placed on local automotive manufacturers such as Ford led to the adoption of lean production techniques between 1988 and 1993. Other innovations implemented by local car manufacturers included better inventory management using just-in-time delivery of component parts. Similarly, greater emphasis was also placed on modernising production facilities in the TCF industry. The level of technology employed in the capital-intensive segments of the industry became comparable with that used by firms elsewhere in the world. Adoption of new technology in the clothing industry increased, including installation of programmable sewing machines, computer aided design and modern warehousing and distribution systems.

*Question 24(d) continues on the next page*

*Question 24(d) continued*

Microeconomic policies have made technology and plant flexibility more important priorities for Australian manufacturers. In response, local businesses have invested heavily in new technologies and capital equipment in an effort to improve the efficiency of manufacturing processes. For example, in the Australian car industry, the use of robots in the welding process was introduced in the mid 1980s. Computer-aided design, computer-aided engineering and computer aided manufacturing have also been employed. Other technologies and capital equipment have been invested in to secure longer model production runs which has required changes in work practices and greater commitment to training and education on the part of local car manufacturers.

### Section III

**Question 25** *Outcomes assessed: H1, H5, H6, H8, H10*

Criteria	Marks
<ul style="list-style-type: none"><li>Provides a clear, comprehensive and balanced understanding of the use of macroeconomic and microeconomic policies to achieve the Government's objectives of price stability and full employment</li><li>Integrates an extensive and appropriate range of economic terms with relevant concepts, relationships and theory</li><li>Synthesises own knowledge with the economic information provided to develop a sustained, logical and cohesive response</li></ul>	17–20
<ul style="list-style-type: none"><li>Provides a clear and comprehensive understanding of the use of macroeconomic and microeconomic policies to achieve the Government's objectives of price stability and full employment</li><li>Integrates an appropriate range of economic terms, relevant concepts, relationships and theory</li><li>Uses own knowledge and the information provided to develop a logical and cohesive response</li></ul>	13–16
<ul style="list-style-type: none"><li>Provides a sound understanding of the use of macroeconomic and microeconomic policies to achieve the Government's objectives of price stability and full employment</li><li>Applies appropriate economic terms, concepts and relationships</li><li>Uses own knowledge and the information provided to develop a cohesive response</li></ul>	9–12
<ul style="list-style-type: none"><li>Sketches in general terms aspects of macroeconomic and microeconomic policies but fails to establish how the policies are used to achieve price stability and full employment</li><li>Uses some appropriate economic terms, concepts and relationships</li><li>Uses the economic information provided to develop a generalised response</li></ul>	5–8
<ul style="list-style-type: none"><li>Lists some limited information about macro and micro economic policies</li><li>Uses some economic terms and/or concepts</li><li>Presents a limited response</li></ul>	1–4

**Essay plan:**

The key economic policies used by the Australian Government to achieve the objectives of full employment (low unemployment) and price stability (low inflation) include monetary policy, fiscal policy, and microeconomic reform policies. Monetary policy is undertaken by the Reserve Bank 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. Fiscal policy is the management of government revenue and government expenditure through its annual budget. Both monetary and fiscal policies are macroeconomic policies used to address economic issues related to the demand side of the economy. Microeconomic reform is the major policy instrument used by the Australian Government to address aggregate supply issues or the productive capacity of the economy in the long run. Microeconomic policies include a diverse range of reforms to promote efficiency, productivity and productive capacity in the Australian economy.

*Question 25 continues on the next page*

Monetary policy is the key macroeconomic policy which has been used to address price stability in the Australian economy. The Reserve Bank of Australia (RBA) has the responsibility for the conduct of monetary policy. Details of the conduct of monetary policy are contained in the *Statement on the Conduct of Monetary Policy* (2010). The Reserve Bank implements monetary policy through the short term money market. This market allows the Reserve Bank to affect the rate of interest or cash rate through the sale and purchase of government securities.

*(At this point in the essay students could demonstrate their knowledge of economic theory and include a diagram that illustrates how the Reserve Bank can change the cash rate in the cash market.)*

A tightening of monetary policy involves the Reserve Bank selling new Commonwealth Government Securities and Repurchase Agreements to banks in the short term money market. This puts upward pressure on the official cash rate and the term structure of interest rates. An easing of monetary policy involves the Reserve Bank purchasing existing Commonwealth Government Securities and Repurchase Agreements. This puts downward pressure on the official cash rate and the term structure of interest rates in the economy.

Between September 2008 and April 2009 the Reserve Bank lowered the cash rate from 7% to 3% in response to declining global and domestic economic conditions brought about by the Global Financial Crisis (GFC). This easing in the stance of monetary policy was designed to support spending and aggregate demand in an attempt to underpin economic and employment growth to prevent rising levels of unemployment. Inflation pressures at this time had eased and inflation was within the Reserve Bank's target band of 2% to 3%. However the unemployment rate had begun to rise from a low of 4.2% and reached 5.8% by 2009. The easing in monetary policy helped to support consumer and business confidence with higher cash flows through cuts to interest rates including mortgage rates and business borrowing rates.

In October 2009 the Reserve Bank's decision to increase the cash rate by 0.25% reflected a change in the Reserve Bank's monetary policy stance. The change in the stance was due to the forecast that economic growth would return closer to trend at 3% to 4%, and to keep the inflation rate consistent with the targeted band of 2% to 3% over the economic cycle. Since October 2009 there have been six increases in the cash rate, with the official cash rate now standing at 4.75%.

This contractionary stance of monetary policy has been adopted in line with the expanding global economy, moderate growth in employment in Australia, and strong commodity prices and the terms of trade. More recently, price increases brought about by natural disasters early in 2011 in Australia have impacted on the headline rate of inflation as measured by the Consumer Price Index. The annual inflation rate currently stands at 3.3%. This is just outside the Reserve Bank's target band. However, the underlying rate of inflation which is also used to guide the setting of monetary policy has declined since 2008 and in March 2011 was 2.25%. There has been no change in the stance of monetary policy since November 2010. However, the Reserve Bank believes that the current cash rate of 4.75% is appropriate, given the current economic conditions. The RBA has forecast that the Consumer Price Index will be more in line with the targeted band within the next 12 months. In the long term the Reserve Bank believes interest rates will rise due to inflationary pressures.

The use of monetary policy to achieve a low inflation environment has been a very important factor in contributing to Australia's economic performance. However, at times the effectiveness of monetary policy can be questioned by issues such as the following:

- The time lag in the implementation phase of monetary policy;
- The notion that it can be a 'blunt instrument' and can have a negative impact on certain sectors of the economy (e.g. this would be the current concern of the retail sector in Australia); and
- Its limitation in stimulating aggregate demand during a downturn (which was evident in the early phase of the GFC in Australia in 2009).

*Question 25 continues on the next page*

*Question 25 continued*

In the short to medium term the use of monetary policy to achieve a low inflationary environment can come at the cost of other government economic objectives, including full employment, economic growth and external stability. Full employment refers to where the natural rate of unemployment is approximately 5% of the labour force or where there is no cyclical unemployment. Unemployment rates below 5% can impact on inflationary pressures especially in relation to wage costs due to a shortage of skilled labour. This was one factor that contributed to inflation in 2008 when the official interest rate was increased to 7.25%.

*(At this point in the essay students could demonstrate their knowledge of economic theory and include a diagram using the Phillip's Curve analysis showing the trade-off in the short run between inflation and unemployment.)*

The use of fiscal policy during the GFC in 2008–09 was fundamental in stimulating economic growth and reducing unemployment. During 2009 unemployment peaked in June at 5.8%, well below government forecasts at the time. The fiscal stimulus which was delivered in three phases by the Rudd Government was timely and seen by many economists as being very effective. Since the peak of unemployment in June 2009, unemployment has fallen steadily to its current rate of 4.9% (May 2011). Budget deficits between 2008 and 2011 reflected a more expansionary stance of fiscal policy to support economic growth and employment. Employment growth eased in the second quarter of 2011. However this is expected to change in the next 12 months with the demand for labour increasing in some sectors of the economy such as mining and engineering. The shortage of skilled labour is still a major concern for some employers and this could put pressure on wage costs in Australia in the future, creating inflationary pressures.

One of the key objectives of the 2011–2012 Federal Budget was to focus on improving the number of skilled workers in the Australian workforce through the *Building Australia's Future Workforce* programme. This programme included \$558m to be delivered through a "National Development Workforce Plan". This plan provided 130,000 new training places over the next four years. As well, \$101m will be spent on a national mentoring programme to assist 40,000 apprentices to finish their training. The 2011–2012 budget also outlined a range of policies to improve opportunities for Australians to participate in the workforce. These fiscal measures will provide additional labour resources to the Australian labour market and help reduce wage cost inflation.

The budget deficit was cut in the 2011–12 budget as the government moved to return the budget to surplus by 2012–13. This reflected a more contractionary stance of fiscal policy to contain the growth in aggregate demand and inflation, consistent with the current stance of monetary policy.

The current use of key macroeconomic policies to address the government's objectives of price stability and full employment in the short to medium term are underpinned by the microeconomic policies of the Australian government to increase aggregate supply or the productive capacity of the economy in the long run. The aim of aggregate supply policies include, amongst other objectives, to promote a low inflationary environment through cutting production costs and promoting full employment through improved efficiency, productivity and competitiveness.

Over the past two decades in Australia a wide range of reforms have been implemented including:

- Trade liberalisation through tariff cuts and reductions in quotas
- Deregulation of the labour market with an emphasis on productivity based wage bargaining
- Budgetary policies including lower tax rates, welfare reforms and measures to increase national savings through superannuation and tax incentives
- Environmental policies such as incentives for the use of cleaner energy sources
- Increased spending on infrastructure and reforms to transport, energy and communications industries

In the short to medium term some microeconomic policy reforms have had a negative impact on the economy by adding to firms' costs and the rate of structural unemployment. However the long term benefits of microeconomic policies are to contribute to the Australian government's achievement of economic objectives, including price stability, economic growth and full employment.

*Question 25 continues on the next page*

In pursuing its economic objectives the Australian government relies on a combination of macroeconomic and microeconomic policies in order to achieve its objectives. The government is continually challenged in framing the appropriate policy mix in a changing global and domestic economic environment.

**Question 26 Outcomes assessed: H1, H2, H3, H4, H5, H6, H7, H8, H9, H10**

Criteria	Marks
<ul style="list-style-type: none"> <li>Demonstrates a clear and concise understanding of the impact of changes in the global economy on Australia's trade and financial flows</li> <li>Integrates appropriate economic terms, relevant concepts, relationships and theory in the extended response answer</li> <li>Synthesises own information with the information provided to develop a sustained, logical and well-structured response to the question</li> </ul>	<b>17–20</b>
<ul style="list-style-type: none"> <li>Demonstrates an understanding of the impact of changes in the global economy on Australia's trade and financial flows</li> <li>Consistently uses appropriate economic terms, relevant concepts, relationships and theory</li> <li>Uses own information and the information provided to develop a logical and well-structured response</li> </ul>	<b>13–16</b>
<ul style="list-style-type: none"> <li>Describes the impact of changes in the global economy on Australia's trade and financial flows</li> <li>Uses appropriate economic terms, concepts and relationships</li> <li>Uses own information and the information provided to develop a coherent response</li> </ul>	<b>9–12</b>
<ul style="list-style-type: none"> <li>Outlines some of the impact of changes in the global economy on Australia's trade and financial flows</li> <li>Uses some appropriate economic terms, concepts and relationships</li> <li>Uses own information to develop a generalised response</li> </ul>	<b>5–8</b>
<ul style="list-style-type: none"> <li>Lists some impact of changes in the global economy on Australia's trade and financial flows</li> <li>Uses some economic terms and/or concepts</li> <li>Presents a limited response</li> </ul>	<b>1–4</b>

**Essay plan:**

The global or world economy refers to the sum of countries that produce goods and services and contribute to global GDP. In addition the global economy involves the international trade of goods and services, the international movement of capital, as well as trade in financial assets such as foreign exchange and financial derivatives. Changes in the global economy, especially changes in world output, trade and the global business cycle, are mainly reflected in a country's balance of payments and movements in its exchange rate.

The balance of payments is a record of all economic transactions between Australia and the rest of the world in one year. The current account records transactions such as exports and imports of goods and services, and net primary and secondary income. The capital and financial account mainly records transactions relating to net portfolio and direct investment. The balance of payments is an important indicator of the Australian economy as it illustrates our international trade and investment performance over time.

The main change in the global economy (as illustrated by the graph on World GDP growth) was a large contraction in world output of  $-0.6\%$  in 2009 as the Global Financial Crisis (GFC) reduced GDP growth in advanced countries by an average  $-6\%$  and world trade and investment flows by around  $-12\%$ . In the lead up to the Global Financial Crisis Australia's current account deficit reached a record level of  $-\$73.9b$  or  $-6.3\%$  of GDP in 2007–08 despite strong growth in resource exports due to the global resources boom between 2003 and 2007.

*Question 26 continues on the next page*

*Question 26 continued*

The growth in the current account deficit in 2007–08 was due to high domestic growth and a rise in import spending, as well as a larger net primary income deficit of -\$49.5b. The high net primary income deficit reflected the increased servicing cost of Australia's debt and equity borrowings overseas through higher remittances of profits, dividends and interest. However most economists were not concerned by the size of the net primary income deficit, as it reflected the increased servicing costs of the surge in foreign investment associated with the boom in the mining and resources sectors of the Australian economy. The capital and financial account surplus in 2007–08 of \$72.8b consisted of increased direct, portfolio and other investment from overseas, as well as a rise in the value of Reserve Assets held by the Reserve Bank.

With the contraction in world output and trade during the GFC in 2009 (as shown in the graph provided), Australia's current account deficit fell back to -\$40.5b or -3.2% of GDP in 2008–09 as import spending slowed, but resource exports continued to grow to China and other Asian countries as they experienced lower growth but did not go into recession like the advanced countries. In 2008–09 Australia recorded a merchandise trade surplus of \$9.1b and the net primary income deficit fell to -\$45.4b as less borrowings from overseas were recorded. There was also a fall in direct foreign investment from \$29.1b in 2007–08 to \$17.6b in 2008–09 as world capital flows fell due to the impact of the GFC. However portfolio investment grew to \$49.2b in 2008–09 as foreign investors took advantage of cheaper share prices in Australian resource companies.

Australia's exchange rate between 2007–08 and 2008–09 fell from an average of \$US0.89 to \$US0.74 as demand for the Australian dollar fell due to lower commodity prices and exports. The terms of trade (which measures the relative prices we receive for exports and pay for imports), also fell by around 20% in this period. The depreciation in the Australian dollar in 2008–09 had the effect of improving Australia's export competitiveness, placing it in a strategic position to capture the benefits of increased export demand once global economic recovery occurred in 2010–11.

As indicated by the extract of text from the May 2011 *Statement on Monetary Policy*, the global economic outlook improved in 2010–11 with the following features:

- Global growth is forecast to be around 4.2 % in 2010–11 and 4.5% in 2011–12 reflecting stronger growth in emerging and developing economies and more modest growth in advanced economies. Global growth of around 4% is about the historical average since 1945 and will help to underpin the continuing demand for Australia's exports in overseas markets.
- Stronger global growth in 2010–11 has resulted in rising commodity prices which has lifted Australia's terms of trade to around 20% higher over the year to the March quarter 2011, mainly due to higher bulk coal and iron ore contract prices. The higher terms of trade is providing external stimulus to domestic economic growth through higher incomes, profits, dividends and wages.
- The current account deficit has averaged -1.8% of GDP for the past three quarters and is well below the historical average of -4.5% of GDP in the previous decade. This is mainly due to rising export income and volumes of resources as strong demand for Australian commodities is being sourced from China, India and other major Asian trading partners.
- The Australian dollar has appreciated strongly against the currencies of most trading partners including the US dollar and euro and also on a Trade Weighted Index (TWI) basis. This appreciation reflects the strong terms of trade and rising commodity prices. The Australian dollar has traded in a narrow range of around \$US1.05 to \$US1.07 for most of 2011.

The current 'two speed' global economic recovery is characterised by subdued growth in most major advanced economies (like the EU and USA) and high average growth in emerging and developing economies such as China, India and ASEAN. Low growth in Europe is sourced from concerns over debt default by several European governments, including Portugal, Ireland, Greece and Spain (the PIGS), and below trend growth in the United States is being sourced from high unemployment, a depressed housing market and high levels of government debt. Fears of another Global Financial Crisis are influencing investor and consumer confidence and this is hampering spending and recovery in major advanced economies. The main concern for Australia is that any widespread default on debt repayments by sovereign governments could raise the global cost of capital and impact negatively on Australia's rate of economic growth. The settings of monetary and fiscal policies in the EU and USA are still accommodative to support economic recovery.

in contrast, growth in major emerging and developing countries like China, India, the Newly Industrialised Economies (NIEs) of Asia, Russia, Brazil and ASEAN are experiencing trend growth of between 5% and 10%. However there have been rising inflationary pressures in China and India and other emerging countries due to higher food and energy prices. Many central banks have therefore lifted interest rates to contain inflation and sustain economic recovery.

Australia has huge reserves of natural resources and is benefiting from the continuing rapid industrialisation of large economies such as China and India through increased resource exports. The rapid growth in Asia is boosting commodity prices, and coupled with an improving terms of trade, Australia has begun to record trade surpluses through increased export values and volumes. In May 2011 the merchandise trade surplus was \$1.6b and the current account deficit for the March quarter 2011 had narrowed to -\$8.1b. The 2011–12 budget forecast for the current account deficit is –2% of GDP in 2010–11 and –4% of GDP in 2011–12.

The strong Australian dollar is supporting purchases of cheaper imports, but the threat of higher interest rates in the future, and continuing negative economic news from Europe over the 'sovereign debt' crisis in the EU, are dampening consumer spending intentions, especially retail sales. There is also a trend for individuals to reduce debt levels and increase savings. Natural disasters in Australia such as the floods and Cyclone Yasi in late 2010 and early 2011 caused a loss of coal exports and put upward pressure on fruit and vegetable prices, adding to inflation in the March quarter 2011. This together with previous interest rate rises by the Reserve Bank has made the household and business sectors more cautious in their spending in 2011.

The increase in savings by households and business also means that banks are less reliant on foreign funds to finance lending for the mining boom. Mining companies have large retained profits and have used these to reduce existing levels of debt. They have reduced their international debt borrowings and raised new capital through equity finance. Overseas investors perceive Australia as a low risk and high return investment destination and this has led to continuing inflows of foreign portfolio and direct investment, especially in the mining and resources sector. This has also supported the Australian dollar's continued appreciation in currency markets.

Australia's historically high current account deficits caused by deficits in the goods and services balance and high net primary income deficits, may change as the mining boom increases exports, and Australia begins to record persistent surpluses. However a major negative impact of Australia's improved trade performance, rising terms of trade and appreciating currency is the loss of competitiveness of some major sectors of the economy. These include the exports of the manufacturing, education and tourism industries, which have lost a significant level of competitiveness in export markets. Also the Australian economy is undergoing substantial structural change as resources including labour and capital are reallocated from these industries into the mining and resource sectors which are expanding strongly due to increased investment in new mineral, gas and infrastructure projects.

## Section IV

### Question 27 Outcomes assessed: H1, H2, H3, H4, H5, H6, H7, H8, H9, H10

Criteria	Marks
<ul style="list-style-type: none"><li>Integrates extensive and relevant economic terms, concepts, relationships and theories</li><li>Provides comprehensive economic information in a sustained logical and cohesive response</li><li>Demonstrates a clear and comprehensive knowledge and understanding of how labour market policy responses can be used to encourage employment, education and training in the Australian labour market</li></ul>	17–20
<ul style="list-style-type: none"><li>Integrates relevant economic terms, concepts, relationships and theories</li><li>Provides sound economic information in a logical and cohesive response</li><li>Demonstrates a sound understanding of how labour market policy responses can be used to encourage employment, education and training in the Australian labour market</li></ul>	13–16

Question 27 continues on the next page

*Question 27 continued*

<ul style="list-style-type: none"> <li>Applies economic terms, concepts and relationships</li> <li>Develops a coherent response</li> <li>Sketches in general terms how labour market policy responses can be used to encourage employment, education and training in the Australian labour market</li> </ul>	9–12
<ul style="list-style-type: none"> <li>Uses some economic terms, concepts and relationships</li> <li>Develops a generalised response</li> <li>States some aspects of how labour market policy responses can be used to encourage employment, education and training in the Australian labour market</li> </ul>	5–8
<ul style="list-style-type: none"> <li>Uses some economic terms and/or concepts</li> <li>Presents a limited response</li> <li>Lists some effects of how labour market policy responses can be used to encourage employment, education and training in the Australian labour market</li> </ul>	1–4

**Essay plan:**

Experience in economies such as Australia over the last couple of decades has shown that monetary and fiscal policies are relatively ineffective in terms of reducing structural unemployment and encouraging longer term employment. Greater emphasis has been placed on microeconomic policy in the form of labour market policies, government employment programmes, and education and training programmes to help workers and employers adjust to structural changes taking place in the workplace.

A major feature of the current Australian industrial relations system is the role of the federal government in passing legislation to establish the principles for wage determination and other industrial relations matters. The *Workplace Relations Act 1996* legislated to introduce AWAs as a third stream of individual wage adjustments in addition to awards and collective enterprise agreements. The allowable matters governed by awards were reduced, greater controls were placed on union power in negotiating Certified Agreements and workers were encouraged to sign AWAs to gain more flexibility with their employer. In 2006 the *Workplace Relations Amendment Act (WorkChoices)* further deregulated the system of industrial relations by creating a unified national system and the application of an Australian Fair Pay and Conditions Standard (AFFCS) to underpin individual and collective workplace agreements.

With widespread community concern over the erosion of minimum wages and conditions under the WorkChoices legislation, in 2007 the Australian government enacted the *Workplace Relations Amendment (A Stronger Safety Net) Act*. This legislation created the Workplace Authority to oversee the registration of individual and collective workplace agreements, and the Workplace Ombudsman to investigate and enforce alleged breaches of minimum wage rates and conditions of employment.

In November 2007 the Labor Party under leader Kevin Rudd won the federal election and formed a new Australian government. A major part of its policy platform was the repeal of the WorkChoices legislation because of its perceived unfairness in eroding minimum wages and conditions of employment. The *Workplace Relations Amendment Act (Transition to Forward with Fairness) Act 2008* was passed by the Australian parliament on March 19<sup>th</sup> 2008. The Act implemented transitional arrangements for the process of phasing out WorkChoices (including the prohibition of AWAs) laws by January 2010 and introducing Fair Work Australia as the main body to oversee the industrial relations system in Australia. The *Fair Work Act 2009* legislated ten National Employment Standards, a system of Modern Awards and rules for Collective Agreements based on 'good faith bargaining'.

Labour market reform policies have been the main response of the Commonwealth Government to the ongoing need to encourage employment, education and training in the labour market. Labour market reform policies are designed to reform labour markets and encourage more competitive work practices and higher levels of labour productivity. This in turn should lead to higher levels of employment as employers have greater incentive to hire additional workers. Labour market deregulation and the movement towards decentralised wage determination where firms and employers are able to negotiate wage increases on the basis of improved productivity has been the central component of Australia's labour market reform agenda. The continuing process of award simplification in order to make awards simple instruments that do not impede workplace efficiency and employment growth, is another key element of the government's reform agenda.

*Question 27 continues on the next page*

Labour market policies such as the deregulation of the wage determination system by successive Australian governments were based on the belief that more flexible wage setting arrangements can increase labour productivity and improve Australia's macroeconomic performance. The movement away from the reliance on the award system to workplace or enterprise bargaining in the 1990s and 2000s has led to greater productivity bargaining and changes in work practices, in return for higher wages and better working conditions. Increasing the efficiency and productivity of labour in the workplace has been achieved through a number of means:

- The encouragement of multi-skilling, where workers acquire new skills in performing a variety of work tasks, adding to their productivity and the technical efficiency of the enterprise or firm;
- The development of employee career paths, with prospects for higher wages offered as incentives to employees who undertake further education and training;
- The trend towards the broad banding of awards through reducing the number of awards, and grouping specialist labour skills or job categories under one award;
- The development of key competencies in job training (such as working in teams and using new technology) so that employees can transfer and apply skills to a variety of occupations; and
- An emphasis on training and education and the acquisition of formal qualifications in areas of specialist labour skills, especially in the use of new capital equipment and technology.

Labour market programmes have traditionally been used as a means of direct intervention in labour markets in order to encourage employment and reduce unemployment. In the Australian context, numerous labour market programmes to assist the unemployed have been implemented over the past two decades by Labor and Coalition governments. These programmes have usually involved one or more of the following measures:

- a) Job search assistance, job clubs or individual employment counselling services (including the Work for the Dole Scheme and the Youth Allowance)
- b) Public training programmes, employment subsidies and direct job creation programmes
- c) Special youth assistance programmes involving apprenticeships and traineeships
- d) Subsidies for private sector employment

These programmes generally aim to increase the ability of the unemployed to compete effectively in the labour market by increasing their basic work skills.

Education and training programmes have always had their place in employment strategies with attempts being made to improve the links between school based education and the acquisition of skills necessary for successful entry to the workforce. In Australia, emphasis has been placed in recent years on improving national literacy and numeracy standards in schools to raise basic educational skills and the employability of school leavers.

The 2011–12 Commonwealth Budget announced a number of measures designed to encourage skill-building and greater participation in the workforce by disadvantaged groups. The *Building Australia's Future Workforce* package incorporated steps to help industries get the skilled workers they need and encourage participation in work. This was to be achieved through:

- Improved income tests and employer incentives to hire labour;
- Providing new opportunities to get more people into work through training, education, childcare and employment services;
- New employment requirements for teenage parents, the long term unemployed and Disability Support Pension recipients; and
- New approaches to address entrenched disadvantage in targeted locations and regions.

The package included \$558m to deliver around 130,000 quality training places tailored to meet the needs of different industries and regions through a National Workforce Development Fund; continuing investments to improve the apprenticeship system with \$200m to assist apprentices to progress and complete their training; \$1.75b to partner with the States and Territories on reform of the vocational education and training system; and \$263m to deliver core skills to open new opportunities for employment.

*Question 27 continues on the next page*

*Question 27 continued*

Finally, regarding the impact of government labour market intervention, there is little doubt that the benefits have underpinned Australia's strong economic performance over the past two decades. It is important to present data as evidence of the positive effects of recent labour market policy. The Productivity Commission estimated that labour productivity in Australia's market sector increased by 2.2% in 2005–06 which was around the long term average of 2.3% per year since the early 1990s. All the labour productivity growth in 2005–06 was due to above average capital deepening (i.e. increases in the capital to labour ratio) of 2.3%. Other factors attributed to the rise in labour productivity in the 1990s and 2000s were improvements in the quality of labour through education and training, and improvements in the efficiency with which labour and capital are used in production.

At the macroeconomic level, labour market reform has led to rising rates of real GDP or income per head and improvements in living standards. In addition, rising labour productivity underpinned Australia's average 3.5% rate of economic growth between 1994 and 2007 (prior to the GFC).

Other macroeconomic benefits of successful labour market reform include the enhanced international competitiveness of the traded goods sector (i.e. exports and import substitutes) and wage outcomes consistent with rising productivity, which do not add to inflationary pressures on the supply side of the economy. To this extent inflation outcomes in the Australian economy have been more moderate since the adoption of a more flexible system of wage determination, characterised by the decentralisation of wage negotiations away from the rigid centralised system, to a more flexible system of collective and individual productivity bargaining.

**Question 28** *Outcomes assessed: H1, H2, H3, H4, H5, H7, H9, H10*

<b>Criteria</b>	<b>Marks</b>
<ul style="list-style-type: none"><li>Integrates extensive and relevant economic terms, concepts, relationships and theories</li><li>Provides comprehensive economic information in a sustained logical and cohesive response</li><li>Demonstrates a clear and comprehensive knowledge and understanding of the influence of globalisation on an economy other than Australia and evaluates the strategies used to promote economic growth and development</li></ul>	<b>17–20</b>
<ul style="list-style-type: none"><li>Integrates relevant economic terms, concepts, relationships and theories</li><li>Provides sound economic information in a logical and cohesive response</li><li>Demonstrates a sound understanding of the influence of globalisation on an economy other than Australia and evaluates the strategies used to promote economic growth and development</li></ul>	<b>13–16</b>
<ul style="list-style-type: none"><li>Applies economic terms, concepts and relationships</li><li>Develops a coherent response</li><li>Sketches in general terms the influence of globalisation on an economy other than Australia and the strategies used to promote economic growth and development</li></ul>	<b>9–12</b>
<ul style="list-style-type: none"><li>Uses some economic terms, concepts and relationships</li><li>Develops a generalised response</li><li>States some aspects of the influence of globalisation on an economy other than Australia and the strategies used to promote economic growth and development</li></ul>	<b>5–8</b>
<ul style="list-style-type: none"><li>Uses some economic terms and/or concepts</li><li>Presents a limited response</li><li>Lists some effects of the influence of globalisation on an economy other than Australia and the strategies used to promote economic growth and development</li></ul>	<b>1–4</b>

*Question 28 continues on the next page*

**Essay plan:**

The process of globalisation refers to the increasing level of economic integration between countries and regions in the world. Economic integration occurs when barriers to trade and investment are lowered between countries through the dismantling of tariff and other non tariff barriers, and the easing or removal of restrictions on the mobility of capital flows. This may occur unilaterally or through the signing of bilateral and multilateral free trade agreements. For example, regional economic integration has been achieved between countries in the European Union, North America (through NAFTA) and in the Asia Pacific (through the APEC forum). These agreements have led to the rapid growth of intra-regional trade and provided the impetus for substantial growth in world trade and investment flows sourced from these three regions.

Another factor which has led to increased economic integration and accelerated the globalisation of economic activity is the reduction in costs and improved efficiency of transport, communications and technology. This has led to closer links between global markets and the rapid growth of electronic commerce, global production and distribution networks which are based on generating economies of scale in production for a world market.

Whilst globalisation has influenced the development of most countries in the world to a large extent, China stands out as a large and populous country whose rapid economic growth and development has been spurred by its integration into the global economy. This has been supported by deliberate changes in economic policy by the Chinese government to open the Chinese economy to world trade and investment flows in developing its resources, and raising living standards for the Chinese population. Globalisation has led to the manufacture, marketing and distribution of goods and services in China for export to the world market, as well as distribution to the growing Chinese middle class which has enjoyed rising incomes, increased rates of urbanisation and the demand for luxury goods and services.

Students could select one from a number of case study countries (such as China, India, Korea, Taiwan, the United States, Singapore, Britain, Germany, France, Poland, Italy, Ireland, Brazil, and Russia) to discuss the influence of globalisation and evaluate the strategies used by their governments to promote economic growth and development.

The link between the globalisation of world economic activity and the rates of economic growth and development in countries is that once barriers to trade and investment are lowered, this gives a country access to the large global market for its exports and foreign capital to develop its economy. If a country can sustain a higher rate of economic growth through increased exports, the resulting rise in national income should lead to improved standards of living and the quality of life for its citizens. However participation in the process of globalisation does not guarantee improved rates of economic growth and development if government policies do not ensure that growth and employment occur in key sectors such as export, manufacturing, agricultural and service industries. Also governments need to ensure that the benefits of higher levels of economic growth and development lead to higher incomes for the population as a whole and an improvement in the quality of life through higher rates of literacy, life expectancy, access to clean water and environmental sustainability. World Bank research (2007) suggests countries that are 'globalisers' and open their markets to world trade tend to sustain higher rates of growth and development than countries that are 'non globalisers' and maintain closed markets to international trade.

China has followed the model of Japan, Korea, Taiwan, Hong Kong and Singapore in the Asian region by embarking on rapid industrialisation to develop its economy. It is now an increasingly industrialised and urbanised society with open markets, a large export sector and high levels of foreign direct investment. China is the world's second largest economy in PPP terms and the largest country in the global economy in terms of population size. China has a socialist economy ruled by a Communist government, which has modernised agriculture and industry through a range of market based or capitalist economic reforms since the Communist revolution in 1949.

*Question 28 continues on the next page*

*Question 28 continued*

The reform process began in 1979 when Deng Xiao Ping, the leader of the Communist Party, implemented policies to improve China's economic performance and level of development:

- The 'one child policy' was introduced to stabilise the growth in China's burgeoning population. This has limited population growth and reduced the demand for resources needed for economic development.
- Agriculture was reformed through the de-collectivisation of farming with the abandonment of the commune system and its replacement with the Household Responsibility System. This allowed Chinese farmers to sell their surplus output in free markets after they had met state production quotas. This led to a large increase in Chinese food production. Surplus income was invested in privately run town and village enterprises (TVEs) responsible for the light manufacturing of industrial goods.
- In 1980 an 'open door policy' was adopted towards foreign trade and investment, with Special Economic Zones (SEZs) established in the southern and eastern coastal provinces of China. These SEZs attracted foreign investment and MNCs through a range of incentives such as low tax rates, exemption from import duties, cheap labour and power, and less government regulation. Trade in exports and imports grew from 10% of China's GNP in 1978 to 36% of GNP by 1996. Inflows of foreign capital increased China's access to export markets, transfers of Western technology and management skills, and created substantial employment for cheap, low skilled labour in the manufacturing sector.
- In 1994 taxation reforms were introduced by the Chinese government. These reforms shifted the power to collect taxes away from provincial governments to the central government in Beijing, in order to improve the efficiency of tax collection and to finance infrastructure spending. These reforms also targeted tax evasion and avoidance, which were major problems encountered in raising sufficient taxation revenue to meet the central government's spending commitments.
- Banking laws were introduced in 1995, to develop a system of network banking, establish stock exchanges, and promote a more efficient capital market to facilitate saving and investment in China. The banking system is based on network branch banking and large industrial and commercial banks which provide funds to Chinese companies.
- In 1992 cuts to tariffs and other forms of protection were used to encourage greater domestic efficiency through direct import competition. China's average tariff rate was cut from 32% to 19% in 1996 and reduced to 15% in 2000. These cuts in import protection supported China's drive to attract foreign investment and open its domestic market to foreign competition.

Deng Xiao Ping's successor, Jiang Zemin, continued the quest for rapid economic growth through export growth, stimulated by foreign investment. The current leader of China, Hu Jintao, has also pursued a policy of high growth as the key to rapid economic development. China has joined the WTO and hosted the 2008 Olympic Games where it 'showcased' its achievements in economic and human development to the world.

China sustained an average annual growth rate of GDP of 10% between 2004 and 2008, but this growth rate fell to 8.7% in 2009 due to the Global Financial Crisis (GFC). In response to the GFC the Chinese government implemented a fiscal stimulus package worth US\$586b to support growth at 8% in 2009–10. Growth is forecast at 10% in 2010–11 after China made a successful recovery from the impact of the GFC by switching the sources of growth from exports and foreign investment to greater reliance on domestic consumption and investment spending.

In terms of economic development China has been successful in raising per capita incomes, increasing adult literacy and life expectancy, as well as other material and non material indicators of development. Life expectancy rose from 63.2 years in 1975 to 72.9 years in 2007 and GDP per capita grew at an average rate of 8.2% annually between 1975 and 2007 to be US\$5,383 in 2007. Adult literacy has also improved from 78.3% in 1975 to 93.3% in 2007. In terms of these three Human Development Index (HDI) indicators, China's HDI value rose from 0.53 in 1975 to 0.772 in 2007, ranking it 92nd out of 182 countries in the UNDP's HDI list in 2009.

*Question 28 continues on the next page*

In evaluating the strategies used to promote economic growth and development in China it is important to note that China's rapid growth and development in such a short time in history has involved substantial costs as well as benefits. Chief amongst these are problems with inflation, environmental sustainability and the distribution of income. Price inflation continues to be 4% to 5% per annum because of the high rate of economic growth and demand for resources. The Bank of China raised interest rates and imposed quantitative restrictions on lending in 2011 to reduce inflationary pressures in the economy including excessive speculation in the real estate market.

In terms of environmental sustainability China accounts for 16% of world carbon dioxide emissions, sourced mainly from coal fired power stations. The Chinese government has moved to increase power sources from nuclear energy and hydroelectricity to reduce emissions. Other environmental problems associated with unsustainable growth include the rapid rate of environmental degradation of natural resources such as forests, biodiversity and water supplies. China also has high levels of air pollution and a high incidence of respiratory illnesses amongst the population. These environmental problems are estimated to detract up to 7% from China's annual GDP and the Chinese government has implemented policies such as increased spending on environmental protection in its annual budget to address these problems.

Along with higher inflation and environmental degradation associated with rapid economic growth, China's distribution of income has continued to be skewed in favour of the eastern, southern and northern provinces (where the major cities and SEZs are located) and against the western and rural provinces. High growth in per capita incomes and HDIs tend to be concentrated in large coastal cities which have benefited from increased trade and investment, whereas the population in vast inland western provinces tends to experience much slower growth in incomes and HDI indicators.

The Chinese government has addressed this problem by concentrating new investment projects (including infrastructure) in rural regions and increasing its spending on health, education, housing and social welfare in poorer rural regions to improve living standards and the quality of life.

**NSW INDEPENDENT TRIAL EXAMS – 2011**  
**ECONOMICS TRIAL HSC EXAMINATION**  
**MAPPING GRID**

Question	Outcome(s) assessed
1	H1, H6
2	H1
3	H1, H8
4	H1, H4
5	H1, H7
6	H1, H8, H11
7	H1, H5
8	H1
9	H1, H11
10	H1, H8, H11
11	H1, H4, H9, H11
12	H1, H2, H4, H7, H11
13	H1, H2, H6
14	H1, H11
15	H1, H2, H4
16	H1, H7, H11
17	H1, H11
18	H1, H6
19	H1, H11
20	H1, H4
21(a)	H1, H4
21(b)	H1, H7
21(c)	H1, H2, H6
21(d)	H1, H4, H8
22(a)	H1
22(b)	H1, H4, H8
22(c)	H1, H7
23(a)	H1
23(b)	H1, H2
23(c)	H1, H2, H5, H6
23(d)	H1, H2, H6, H7
24(a)	H1
24(b)	H1, H5, H6
24(c)	H1, H2, H5, H6
24(d)	H1, H2, H5, H6, H7
25	H1, H5, H6, H8, H10
26	H1, H2, H3, H4, H5, H6, H7, H8, H9, H10
27	H1, H2, H3, H4, H5, H6, H7, H8, H9, H10
28	H1, H2, H3, H4, H5, H7, H9, H10

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