2000 NSW INDEPENDENT TRIAL EXAMS
ECONOMICS 2 UNIT

SUGGESTED ANSWERS

These suggested answers / marking schemes are issued as a guide only, offered as an assistance in constructing your own marking format (individual teachers/schools find many other acceptable responses)

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

QUESTION 21.

(a) (i) The current account deficit for 1998-99 was -$32,400m.

(ii) The change in the merchandise trade balance between 1997-98 and 1998-99 was -$9,354m.

(b) Two reasons for the increase in the current account deficit between 1997-98 and 1998-99 was the increase in the merchandise trade deficit (due to the decline in export demand because of the 'Asian Crisis') and the rise in import spending which reflected strong domestic economic growth. There was also a rise in the net services deficit due to falling inbound tourism.

(c) A persistent current account deficit must be financed by either debt or equity borrowing from overseas. A rise in debt borrowings will lead to a rise in Australia's net external debt with interest payments causing the net income deficit to rise in the current account. This could lead to a vicious cycle of foreign debt accumulation.

(d) To reduce the size of the current account deficit the government could use monetary policy to contain inflation and spending on imports by achieving sustainable growth. Fiscal policy could be used to achieve fiscal balance thereby raising public savings which could reduce Australia's reliance on foreign savings. Industrial relations policy can help to increase competitiveness by linking wage movements to improvements in productivity. Other microeconomic reforms such as tariff reductions can be used to increase export competitiveness.

QUESTION 22

(a) (i) The fax free threshold level of income in the table is $6,000.

(ii) The averages rate of taxation is $\frac{T}{Y} \times \frac{100}{1}$

A person earning $50,000 would pay $11,380 in tax or a 22.76% average rate of taxation.

(b) The marginal rate of taxation refers to the extra taxation payable on an extra dollar of income earned.

$$MRT = \frac{\rho T}{\rho Y} \times \frac{100}{1}$$

(c) The marginal rate of taxation for a person earning $45,000 is 30%.

(d) Two economic costs of broadening the tax base (by introducing the GST) is the regressive effect is may have on low income earners who lose a greater proportion of their gross income in tax than higher income earners. Another implication may be 'one off' rise in prices due to the GST.

(e) Two economic benefits of introducing the GST include raising additional revenue to finance government spending and to cut income tax rates. The GST also replaces the existing complexity of various indirect taxes.

(f) Need to look at reasons for reform of our tax system and move to GST

- Reduce the impost of current commodity taxes on business inputs
- Reduce the regressivity of current indirect taxes
- Reduce income tax rates and improve incentives to save
- Reduce the incidence of evasion and avoidance
- Replace current indirect taxes with a single indirect tax
- Raises sufficient revenue for governments to cut marginal rates of tax

QUESTION 23

The economic objectives of the Australian government include internal balance (price stability and full employment), economic growth and external balance (equilibrium in the balance of payments, appropriate level of foreign debt and a stable exchange rate). Other objectives include increased efficiency and international competitiveness.

The Australian government uses a mix of policies (such as monetary, fiscal, industrial relations and microeconomic reform) to achieve its economic objectives.

Monetary policy is used to stabilise economic activity in relation to changes in the business cycle. The Reserve Bank can use market operations to alter the cash rate. Changes in interest rates are used to achieve the RBAs inflation target of 2% to 3% over the economic cycle. An expansionary monetary stance was used between 1996 and 1998 to stimulate employment growth. Since 1999 four rises in the cash rate have been implemented to reduce inflationary pressures.

Fiscal policy through the use of the budget's instruments of taxation and government spending has been used to achieve fiscal balance over the economic cycle. Fiscal surpluses between 1996 and 2000 have been used to raise public saving and reduce Commonwealth debt. Fiscal policy has been assigned the role of raising national saving to reduce Australia's call on foreign saving and the current account deficit. The 2000-2001 budget also saw the introduction of the governments New Tax System.

Microeconomic policies are directed at improving efficiency in markets, thereby assisting microeconomic performance.

- Industrial relations reform in the labour market
- Cuts in protection to increase competitiveness
- The introduction of the national competition policy
- Reform of public trading enterprises
- Taxation reform

QUESTION 24

Students should define inflation and unemployment.

Recent trends in inflation include low rates of below 3% achieved by Australia in the 1990s in both headline (CPI) and underlying teams. This has been due to more competition in the economy and the effective conduct of monetary policy. Inflation will rise to over 5% in 2000-01 due to higher world commodity prices, a weak exchange rate and the introduction of the GST.

Recent trends in unemployment include a decline in the unemployment rate from 11.1% in 1992 to under 7% in 2000 due to stronger economic growth and labour market reforms.

The causes of inflation may be demand pull or cost push pressures in the economy. Demand pressures include credit growth and cost pressures include wage rises not related to productivity improvements or rises in the price of raw materials.

The causes of unemployment include structural, cyclical and international factors.

Policies used by the Australian government to reduce inflation include the adoption of an inflation target by the RBA of 2% to 3% inflation over the economic cycle. The national competition policy, cuts in protection and the spread of workplace agreements (linking wages to productivity) have also been used to promote lower inflation.

Policies to reduce unemployment include raising sustainable economic growth to reduce cyclical unemployment and reforms in the labour market (such as changes implemented under the Workplace Relations Act 1996), the Job Network and the Work for the Dole scheme. Additional spending on apprenticeship and training places has been used to target structural and long term unemployment.

A major problem experienced in attempts to simultaneously reduce inflation and unemployment include the short run trade off between inflation and unemployment. In the longer run, this trade off tends to diminish as the economy experiences a non accelerating inflation rate of unemployment (NAIRU) which must be reduced through labour market reforms.

QUESTION 25

An award is a legally binding agreement setting out the minimum wages and working conditions for particular occupations or types of work. Awards are administered by the AIRC (federal awards) and state industrial tribunals (state awards). A workplace agreement can be either a Certified Agreement (negotiated directly by unions and employers) or an Australian Workplace Agreements (AWA's) negotiated on an individual basis by employees and employers.

The government has reformed the system of wage determination in Australia by moving from a highly centralised system of wage indexation to a more decentralised system based on enterprise or workplace agreements which incorporate changes to work practices designed to raise productivity and international