



Practice Economics Extension Exam

Multiple Choice

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

Short Answers

Question 21

- (a)** Globalisation refers to the increased integration between different countries and economies, and the increased influence of international forces on all aspects of life and economic activity.
- (b)** Global trade flows strengthen the transmission of the international business cycle between different economies. Stronger growth in one economy will lead to increased demand for exports from another economy, boosting growth in the second economy. Global investment flows also mean that stronger economic conditions in one economy make it more likely that businesses in that economy will invest in new operations in other countries, boosting growth in the recipient country.
- (c)** The role of the International Monetary Fund (IMF) is to maintain stability on global financial markets. If an economy experiences a financial crisis, the IMF responds by developing a rescue package consisting of short term lending arrangements to help stabilise the economy. The IMF often requires countries to adopt 'structural adjustment' policies as a pre-condition of receiving assistance. These policies include liberalising trade, deregulating the financial sector and balancing the government budget.
- (d)** Greater economic integration between different countries has seen increased trade flows between economies. Individual economies are able to specialise in the areas of production in which they have comparative advantage and trade with other economies, thereby maximising both countries' standards of living. Global integration also means that small economies have access to overseas capital markets as a source of funds for domestic investment, allowing for higher rates of economic growth. However, a disadvantage of greater economic integration is that individual economies are more exposed to downturns in the international business cycle. A recession in the major advanced economies can lead to a synchronised downturn in smaller economies through trade, investment and financial linkages. A second disadvantage of greater integration is that speculative financial flows often have a destabilising effect on developing economies by creating exchange rate volatility.

Question 22

- (a)** The unemployment rate is calculated as the number of people unemployed as a percentage of the labour force. The labour force is the sum of those who are employed (those who work at least one hour per week) and those who are unemployed. To be unemployed, a person must be without work but be actively seeking work.
- (b)** The non-accelerating inflation rate of unemployment refers to the level of unemployment at which there is no cyclical unemployment. It is the lowest level of unemployment that can be achieved before inflation increases.
- (c)** After falling throughout the mid 2000s, the unemployment rate increased slightly to just under 6 per cent in early 2009. This was due to the impact of the global financial crisis, which saw a mild downturn in domestic economic growth throughout 2008-09. Lower growth meant that firms cut back production, and consequently laid off some of their workers.
- (d)** In the short run, unemployment and inflation are inversely related. Lower unemployment tends to be associated with higher inflation rates, and vice versa. Higher economic growth creates jobs and reduces unemployment, but it can also lead to excessive aggregate demand, pushing up demand-pull inflation. Lower unemployment also creates extra demand in the labour market, pushing up wages and adding to cost-push inflation. For governments, there is a short run trade-off between inflation and unemployment, as represented in the Phillips Curve. However, in the long run the relationship between inflation and unemployment is determined by the level of inflationary expectations and the economy's natural rate of unemployment.

Question 23

- (a)** After several large surpluses throughout the 2000s, the budget outcome shifted to deficit in 2008-09 with the onset of the global financial crisis. The budget outcome is expected to remain in deficit until 2012-13.
- (b)** Fiscal policy is limited by political constraints such as the role of the Senate. Many economic policies that are implemented through legislation face major amendments or compromises in order to pass the Senate. A second limitation on fiscal policy is the role of global governmental forums such as the Group of Twenty Nations (G20), which can have an influence over domestic macroeconomic policies.
- (c)** During a downturn, there are fewer employment opportunities and incomes may be falling. Falling incomes move workers into lower income tax brackets, and many newly unemployed workers do not pay tax. This leads to a decrease in income taxation receipts. At the same time, weaker economic activity leads to higher unemployment and increased welfare expenditure on unemployment benefits. The combined effect of the decrease in income taxation and increase in government expenditure is to worsen the budget outcome and boost economic activity, thereby playing a countercyclical role.
- (d)** The government can directly add to national savings by running a fiscal surplus. On the other hand, when the government budgets for a fiscal deficit, it must draw on the supply of national savings. Fiscal policy can also increase private savings, such as through the introduction of compulsory superannuation in the early 1990s. More recently, the Government's proposal to increase compulsory superannuation from 9 per cent to 12 per cent should also raise the level of national savings. The government can also increase national savings by affecting the incentives to save. For instance, the superannuation co-contribution scheme encourages individuals to make voluntary contributions to their superannuation savings. In the 2010-11 Budget the Government also announced a tax discount for the first \$1,000 of interest income earned, increasing the incentive to save.

Question 24

- (a)** The international business cycle refers to the synchronisation of economic growth trends between different countries in the global economy.
- (b)** The commodities boom has boosted Australia's export revenue and increased economic growth. Strong growth in emerging markets has increased demand for Australia's mineral and metal exports, leading to higher prices and improving the terms of trade.
- (c)** Higher commodity prices are likely to lead to higher export revenue for commodity exports, particularly minerals and metals. This will improve Australia's balance on goods and services, as well as the current account. However, higher commodity prices may also encourage greater foreign investment on the capital and financial account. Changes in commodity prices can also encourage speculation and lead to volatility in the exchange rate.
- (d)** The government can use microeconomic policy to increase the sustainable economic growth rate in the long term. The decentralisation of the labour market and the shift towards enterprise bargaining allows wage rises to be linked to productivity improvements, reducing cost-push inflation and increasing productivity. Productivity is the key factor influencing economic growth in the long term. Policies to increase competition in the economy – such as the National Competition Policy – are also likely to increase productivity by encouraging firms to innovate and adopt cost-minimising production techniques. Reducing trade protection also leads to productivity gains, as it encourages resources to be reallocated towards those industries which have comparative advantage and use them most efficiently. Policies to increase the skills and education of the workforce can also boost long term economic growth by increasing productivity and participation. Relieving capacity constraints in export infrastructure will also improve Australia's long term export potential, boosting the level of sustainable economic growth.