



# Practice HSC Economics Exam

## Multiple Choice

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

## Short Answers

### Question 21

- (a)** One way is the Gini co-efficient of an economy, which is an index of income inequality ranging between 0 and 1, with a number closer to 1 indicating a higher degree of inequality. A second way is the Lorenz curve, with greater inequality indicated by the greater distance the Lorenz curve deviates from the line of absolute equality.
- (b)** Income refers to the flow of funds over a period of time to individuals or households from the sale or exploitation of their factors of production (being land, labour, capital or enterprise). Wealth refers to the stock of assets held by an individual or household at any particular point in time.
- (c)** Differences in age, education and experience can contribute to income inequality in Australia. Those who are older, more experienced and possess higher educational levels have a greater capacity to earn higher incomes.
- (d)** The government can attempt to reduce wealth inequality by implementing policies to boost the accumulation of assets amongst low-wealth households. An example of this is the introduction of compulsory superannuation in 1992 (and more recently the proposed increase in the superannuation guarantee from 9 to 12 per cent by 2019), which boosts the wealth of low-wealth households proportionately greater than higher-wealth households. This is because a superannuation fund is likely to be the most significant asset held by a low-wealth individual or household. Nevertheless, tax concessions given to voluntary superannuation contributions have mainly benefited high income earners who can afford to set aside extra income towards superannuation. Over time, this arguably worsens wealth inequality. Other policies that could reduce wealth inequality include tax incentives for low-wealth households for savings or housing; and progressive taxation on assets such as land, businesses or shares.

**Question 22**

- (a)** The transmission mechanism refers to the causal link between changes in the cash rate (and hence general interest rates in the economy) and changes in aggregate demand. In other words, it refers to the impact of interest rate changes on the level of economic activity in the economy.
- (b)** Throughout 2010, monetary policy was progressively being tightened following indications that the Australian economy had begun its economic recovery after the mild downturn experienced during the global financial crisis. As inflation began to pick up throughout 2010 to reach the upper limit of the Reserve Bank's 2-3 per cent target band, the RBA responded by raising its cash rate to 4.75 per cent as of January 2011 in order to moderate aggregate demand and prevent an overheating of the economy.
- (c)** Monetary policy changes can have an indirect impact on imported inflation by affecting the exchange rate under a floating exchange rate system. For example, when the Reserve Bank raises interest rates to fight inflation, this will increase Australia's interest rate differential. In turn, higher domestic interest rates relative to overseas will attract greater foreign capital inflows, due to higher potential returns. This will increase the demand for Australian dollars on the FOREX market, in turn causing an appreciation of the Australian dollar. An appreciation reduces the cost of imports when expressed in Australian dollars, in turn reducing the price of imported goods on the domestic market.
- (d)** Through its domestic market operations undertaken in participation with financial institutions in the overnight money market, the Reserve Bank will sell second hand Commonwealth Government Securities (or repurchase agreements) at a discount. Other participants in the overnight money market will draw down the funds in their exchange settlement accounts held with the Reserve Bank, in turn reducing the supply of short-term funds in the overnight money market. This will place upward pressure on the cash rate, causing general market interest rates to increase. Higher interest rates, through the transmission mechanism, will lead to a reduction in aggregate demand as domestic consumption and investment fall. This will lower demand pull inflation and inflationary expectations in the economy. Furthermore, higher interest rates will attract more foreign investment, causing an appreciation in the currency and making imports cheaper, thereby indirectly reducing imported inflation.

**Question 23**

- (a)** A transnational corporation (TNC) is a company that has production facilities and shareholders in at least two different countries.
- (b)** One positive impact of transnational corporations is that they have led to an expansion of trade, finance and investment flows in the global economy. TNCs contribute to over one-third of total global trade volumes and are the dominant source of foreign direct investment. A negative impact of TNCs is that they often exploit labour in developing countries. Wages paid by TNCs to labourers from developing countries are often substantially lower than wages they would otherwise have to pay in developed economies.
- (c)** First, TNCs can facilitate the growth of international trade. Over one-third of total annual trade flows are undertaken by TNCs transferring semi-finished products between production facilities worldwide. Second, TNCs are the main provider of global investment flows in the global economy. When TNCs establish new subsidiaries across the world or merge with existing companies in other countries, they are contributing to the flow of foreign direct investment across borders. This in turn bolsters the influence of large TNCs across the global economy, facilitating stronger economic integration between economies. Third, the business activities of the TNCs play an important role in influencing the international business cycle and regional business cycles. With TNCs responsible for the majority of foreign direct investment flows and a significant proportion of trade flows, they have a significant influence on the level of global growth.
- (d)** Strategies should focus on government policies used to facilitate the forces of globalisation (trade, finance, investment and labour flows), or domestic policies designed to boost business investment, job creation, educational attainment and income levels. Your analysis must look at both the positive and negative impacts of the strategies on the economy of your choice by reference to how it has improved or worsened living standards.

Examples can include:

- Whether the government sought to embrace free trade through liberalisation measures such as lowering protection and participating in trade agreements? If so, what have been some of the short term adverse consequences of these measures? Has the government implemented strategies for export-led development, such as an active industry policy?
- Whether the government implemented measures to attract foreign direct investment (through for example, tax concessions given to foreign companies, the creation of special economic zones for foreign investment, favourable labour and/or environmental regulations etc.)? What negative consequences can an overly eager focus on attracting FDI create in the short term?
- Whether the government liberalised financial markets such that the domestic economy is able to access foreign savings for domestic investment? If so, this can create additional volatility in domestic financial markets which may increase the likelihood of a financial crisis.
- Policies to encourage more highly skilled professionals, workers, researchers and academics to relocate to the domestic economy in order to facilitate the transition into a highly skilled, knowledge-based economy.
- Domestic policies to boost income levels (such as minimum wages and greater labour protection laws), encourage business investment (subsidies and tax concessions, deregulation of key industries), raise education and literacy levels (subsidised education, mandatory primary and secondary education) improve health levels or protect the natural environment.

#### Question 24

- (a)** Deregulation of the labour market refers to the removal of government controls over the labour market in order to facilitate the operation of market forces in the determination of wages and employment outcomes. Decentralisation refers to the system of wages and working conditions being determined between negotiations between individual firms and their employees, as opposed to centralised government determination.
- (b)** Enterprise bargaining can result in improvements in labour productivity by directly linking an employee's wages to their level of productivity. Enterprise bargaining enables employees to directly negotiate the conditions of employment with their employer, and the prospect of higher wages provides greater incentives for employees to work harder and more efficiently.
- (c)** Decentralisation increases income inequality because it allows different wage levels to be determined at different firms rather than having wages centrally determined across the economy. Enterprise bargaining is also likely to see income inequality increase as skilled, well-educated workers use their bargaining power to gain wage increases larger than low-skilled, low-income workers.
- (d)** Labour market policies over the past two decades have generally had a positive impact on the level of unemployment in Australia. A more flexible labour market has enabled Australian workplaces to adjust to changes in economic conditions, providing alternatives to laying people off (such as through job sharing, reduced working hours and wages) during times of recession. Additionally, it has been argued that a more flexible labour market provides greater incentives for firms to employ more labour as it becomes less costly to comply with stringent labour protection laws under Australia's previously highly centralised system. An adverse consequence of greater flexibility has been a greater casualisation of the workforce, contributing to increased numbers of underemployed. Active labour market policies through education, training and employment programs have also helped to reduce structural unemployment in Australia.