PΣΛK
ECONOMICS MOCK TRIAL

2020	HIGHER SCHOOL CERTIFICATE EXAMINATION

Economics

General Instructions	• Reading time – 5 minutes • Working time – 3 hours • Write using black or blue pen • Draw diagrams using pencil • Calculators approved by NESA may be used • Write your NESA number where required
Total marks: 100	**Section I – 20 marks** (pages) • Attempt Questions 1-20 • Allow about 35 minutes for this section **Section II – 40 marks** (pages) • Attempt Questions 21-34 • Allow about 1 hours and 15 minutes for this section **Section III−20 marks** (pages) • Attempt Questions 25 or 26 • Allow about 35 minutes for this section **Section IV – 20 marks (pages)** • Attempt either Question 27 or Question 28 • Allow about 35 minutes for this section

PEAK Academy

Section I−Module A: Language, Identity and Culture

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

Use the multiple-choice answer sheet for Questions 1-20

---

1 Which of the following is an example of a monetary union?

A. APEC
B. ASEAN
C. EU
D. NAFTA

C

2 If investment rises by \$100m in an economy and this raises national income by \$500m. What is the marginal propensity to save in this economy?

A. 0.1
B. 0.2
C. 0.5
D. 0.8

B

3 Which of the following describes a consequence of the appreciation of the Australian dollar to the Australian economy?

A. Increased Import Volume
B. Decreased foreign debt repayments
C. Decreased international competitiveness
D. Decreased interest rates

C

4 What is the equilibrium level of income if C = 50+0.8Y and I = 100?

A. 100
B. 150
C. 250
D. 750

D

PEAK Academy

5 The Reserve Bank of Australia engages in a contractionary monetary policy stance. Which of the following is the most likely result of this decision?

	Inflation	*Australian Dollar*
A.	Increases	Appreciates
B.	Increases	Depreciates
C.	Decreases	Depreciates
D.	Decreases	Appreciates

D

6 What is one way a government can finance a budget deficit?

A. Increase level of exports

B. Services Tax Borrow from the Reserve Bank

C. Encourage welfare recipients into the workforce

D. Increase the rate of its Good and Services Tax

B

7 Which of the following is most likely to reduce income inequality?

A. An increase in the minimum wage

B. A decrease in unemployment benefits

C. Decentralisation of the wage determination system

D. Lower government funding for education and training

A

8 Which of the following policies would be most likely to reduce an economy's non-accelerating inflation rate of unemployment (NAIRU)?

A. Expansionary fiscal policy

B. Contractionary monetary policy

C. Policies that increase factor market competition

D. Policies that decrease product market competition

C

PEAK Academy

9 The table shows Balance of Payments data for a hypothetical economy with a flexible exchange rate.

	$ Billion
Exports of Goods	$20
Imports of Goods	$10
Financial Account	$85
Capital Account	$25
Net services	-$15
Net primary income	????
Net Secondary income	-$65

What is the value of Net Primary Income?

A. $55

B. -$40

C. -$60

D. $160

B

10 Which of the following is an advantage of deregulation of the labour market?

A. An increase in productivity rates

B. Increased protections for workers

C. An increase in the minimum wage

D. A short-term decrease in unemployment

A

11 Which statement best describes public goods?

A. They are always provided by the government

B. They do not have costs of production

C. They can be easily traded

D. They are non-rival

B

PEAK Academy

12 What is the impact of Reserve Bank sales of bonds as part of its market operations?

A. A reduction in liquidity in markets and a decrease in the cash rate

B. A reduction in liquidity in markets and an increase in the cash rate

C. An increase in liquidity in markets and an increase in the cash rate

D. An increase in liquidity in markets and a decrease in the cash rate

A

13 Here is the information for a hypothetical economy. The value of CAD is $70 billion, Net foreign debt is $900 billion, Net foreign equity is $220 billion and GDP is $2300 billion.

What is the NFL for this economy as a percentage of GDP?

A. 3.7%

B. 33.3%

C. 56.7%

D. 29.57%

D

14 Which combination of factors is most likely to decrease in Australia's Trade Weighted Index?

	Terms of trade	*Global interest rates relative to Australian interest rates*
A.	Increase	Decrease
B.	Increase	Increase
C.	decrease	Decrease
D.	decrease	Increase

A

15 Which of the following is most likely to cause inflation in the Australian economy?

A. Higher interest rates in the United States

B. An increase in the Medicare Levy

C. A reduction in the Age Pension

D. An increase in the compulsory superannuation employer contribution

A

PEAK Academy

16 Which of the following is most likely to be of benefit to transnational corporations?

A. Migration laws that encourage international labour mobility

B. Variations in regional business cycles

C. Restrictions on international financial flows

D. Increased trade flows

A

17 A Japanese company purchases an Australian company that pays a dividend to Japanese Shareholders. How would these transactions be recorded on Australia's balance of payments?

	Purchase of the company	*Payment of the dividend*
A.	Debit on the capital account	Credit on the financial account
B.	Debit on the financial account	Credit on the current account
C.	Credit on the financial account	Debit on the current account
D.	Credit on the capital account	Debit on the current account

C

18 Other things equal, an increase in the preference for Australian commodities by USA would:

A. Cause an increase in the supply curve for the AUD and produce a depreciation of the AUD against the USD

B. Cause a decrease in the demand curve for the curve for the USD and produce an appreciation of the USD against AUD

C. Cause an increase in the demand curve for the AUD and produce an appreciation of the AUD against the USD

D. Cause a decrease in the supply curve for the USD and produce an appreciation in the USD against the AUD

C

PEAK Academy

19 What are the circumstances that result in a positive externality?

A. The marginal social cost exceeds the marginal private cost
B. Consumption where a person's enjoyment does not diminish another's enjoyment
C. Consumption by a free-rider
D. The marginal social benefit exceeds the marginal private benefit

D

20 In 2022, one US dollar buys 0.75 Australian dollars. In 2023, one Australian dollar buys 1.25 US dollars. Which statement is most correct?

A. Australian exports to the US are less expensive in 2022 compared to 2023.
B. Goods imported from the US are more expensive in 2023 compared to 2022.
C. There is no change in the exchange rate between 2022 and 2023.
D. For US investors, Australian assets are less expensive in 2022 compared to 2023.

B

PEAK Academy

Section II

40 marks
Attempt Question 21-24
Allow about 1 hour and 15 minutes for this section

Question 21 (10 marks)

a) Define the term economic growth. **1**

Economic growth is the percentage change in the value of goods and services produced in an economy over a period of time, usually one year, adjusted for the rate of inflation

b) The table below shows the change in real GDP for an economy between Year 1 and Year 2.

Year	Real GDP
1	$440,000,000
2	$480,000,000

Using the data in the table, calculate the annual rate of economic growth in Year 2. **1**

$$\text{Annual Rate of Economic Growth in Year 2} = \frac{\text{Real GDP in Year 2} - \text{Real GDP in Year 1}}{\text{Real GDP in Year 1}} * 100$$
$$= \frac{440{,}000{,}000 - 400{,}000{,}000}{400{,}000{,}000} * 100 = 10\%$$

c) Outline TWO possible reasons for the change in the annual rate of economic growth from Year 1 to Year 2. **2**

Answers may include two of the following:
- An increased level of business investment in an economy will lead to an increase in the productive capacity of an economy
- An increase in the rate of productivity (e.g. labour, capital or multifactor productivity) will increase the rate of growth of real output in an economy over time as resources are being used more efficiently.
- The use of new technology will also lead to an increase in the productive capacity of an economy.
- An increased level of government spending on goods and services and/or infrastructure could lead to a higher rate of economic growth.
- An increased level of household consumption expenditure could raise the rate of economic growth.
- An increased level of export income could increase private spending and raise the rate of economic growth.

PEAK Academy

d) Discuss the effects of economic growth on the Australian economy. **2**

Answers may include two of the following:
- An increase in employment opportunities for the workforce (based on the derived demand for labour). This may lead to an expansion in part-time and full-time employment and a reduction in the number of unemployed persons in the workforce
- An increase in the material wellbeing of the nation - this will lead to an increase in living standards through rising per capita incomes and increased purchasing power
- An increase in taxation revenue to the government which may be spent on increased welfare spending to alleviate poverty and improve the equality of the distribution of income
- An increase in the rate of technological progress as new methods and processes of production are used to raise productivity
- An increase in an economy's capacity to export goods and services to overseas markets and generate foreign exchange which can be used to purchase more imports
- A final benefit of economic growth is that higher incomes can lead to an acceleration in business investment and higher saving rates for households

e) Examine the role of microeconomic reform in promoting long term economic growth in Australia. **4**

Answers could include:
Microeconomic reform (MER) 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. Examples of MER in Australia include competition policy, tariff reform, taxation reform, labour market reform and reform in transport and communications industries. Other reforms include the deregulation of certain industries such as the financial sector, domestic aviation and telecommunications to make them more competitive and efficient. A final area of major reform has been the improvement in efficiency of Public Trading Enterprises through the policies of deregulation, commericalisation and privatisation.

The main effect of MER 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 MER 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 (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. Successful microeconomic reforms help to promote economic growth, employment, exports and rising standards of living in the community through higher incomes and lower prices

End of Question 21

PEAK Academy

Question 22 (10 marks)

a) Evaluate the impact of a decrease in interest rates on the Australian dollar. **4**

Answer to include:

- *Definition of exchange rate and how the Australian dollar is measured*
- *Lower returns on investments leads to lower FDI and portfolio investment*
- *Decreased capital inflow as investment is less desirable due to lower returns.*
- *Short term: Demand for AUD decreases; downward pressure on the Australian dollar.*
- *Longer term: increased investment requires increases interest payments which increases capital outflow from the NPY component in the current account. Increased supply of AUD in forex market leads to a depreciation in the longer term.*

b) Country A uses a bilateral exchange rate against Country B whereas Country C uses the trade weighted index. Assess the effectiveness of the bilateral exchange rate in comparison to the trade weighted index. **3**

Answer must include:

- *Definition of bilateral exchange rate and trade weighted index*
- *Trade weighted index measures the value of the exchange rate against a basket of major trading partners*
- *Bilateral exchange rate measures the value of the currency against one other country.*
- *Trade weighted index may be more of an effective measure because it compares the value of the currency against multiple currencies rather than just one other country.*

c) Explain the impact of an increase in the current account deficit on the exchange rate. **3**

Answers could include:

- *The current account deficit could be caused by either a BOGS deficit or NPY deficit or a combination of both. An increase in the BOGS deficit is reflective of a higher volume of imports being purchased. As a result, in order to purchase these imports, the supply of AUD in the forex market will increase. This places downward pressure on the exchange rate which lead to a depreciation. Similarly, an NPY deficit is reflect of increased capital outflow due to payments of interest repayments such as dividends for example. This also represents an increased supply of AUD in the forex market causing a depreciation.*

End of Question 22

PEAK Academy

Question 23 (10 marks)

The following table and graphs show selected data and trends for the Australian labour force in May 2020.

	May 2020	Change between March and May 2020
Employed Persons	12154100	-6.4%
Unemployed Persons	927600	29.5%
Unemployment Rate	7.1%	1.9pts
Participation Rate	62.9%	-3.1pts

https://www.nationalskillscommission.gov.au/sites/default/files/2020-06/NSC_a_snapshot_in_time_report.pdf

a) State the formula for the labour force and calculate the size of the labour force in May 2020. **2**

Labour Force = Employed + Unemployed = 12154100 + 927600 = 13081700

b) Explain what is meant by the participation rate and state the participation rate for May 2020. **2**

Answers must include definition and rate:
- The labour force participation rate is the percentage of the working age population in the labour force (sum of the employed and unemployed)
- The participation rate in May 2020 was 62.9%

c) Outline TWO reasons for the trend in the level of unemployment in Australia between March 2020 and May 2020. **2**

Answers may include two of the following:
- Declining consumer spending
- COVID
- declining business confidence and investment
- structural change in industry and the labour market

d) Explain ONE Australian government policy that could be implemented to overcome the trend in unemployment in the short term and ONE Australian government policy that could be implemented to overcome the trend in unemployment in the long term. **4**

Answers may include:
- Short term policies – The use of expansionary monetary policy by reducing the cash rate to encourage more borrowing and spending on goods and services to increase

PEAK Academy

the demand for labour. Also, expansionary fiscal policy through lower taxes and/or an increase transfer payments/stimulus payment could be used to boost aggregate demand and the demand for labour in the economy.

- Long term policies – These include the use of fiscal policy through infrastructure spending in the economy on projects in ports, roads, railways, telecommunications, electricity, gas, education and health to increase labour demand and long-term productive capacity. Labour market policy can also be used through employment schemes and training programs.

PEAK Academy

End of Question 23

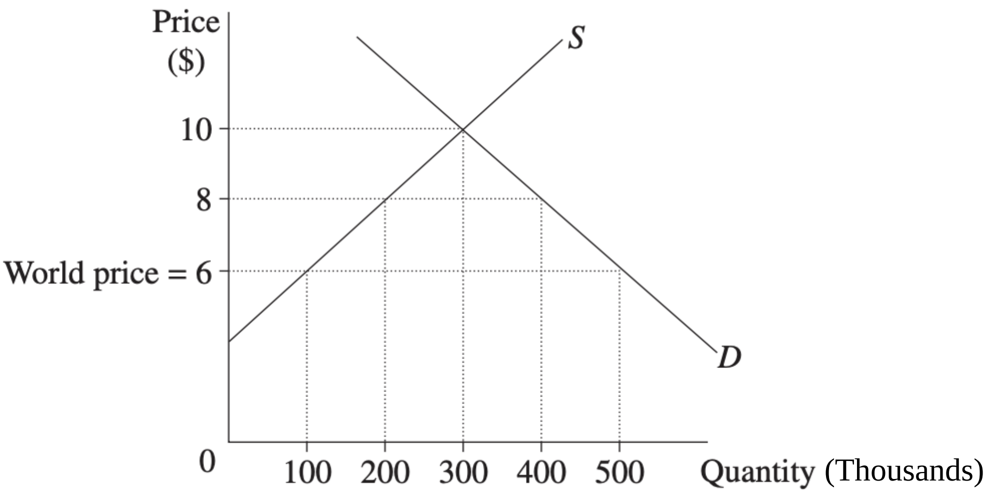
Question 24 (10 marks)

a) Explain how continued globalization can influence climate change. **4**

Answers include:

- *Definition of globalisation: Globalisation involves increased integration and interdependence amongst economies in order to form a single world economy by increasing trade and financial flows, technology transfer and the development of transnational and multinational corporations.*
- *Globalisation directly correlates to increase global production and economic growth and environmental sustainability have a trade-off*
- *Particularly, emerging and developing economies tend to prioritise production and profits over environmental sustainability.*
- *Example: burning of fossil fuels releases carbon dioxide and contributes to the enhances greenhouse effect which can have detrimental effects on climate change*
- *Worsened intergenerational equity*

The following diagram shows domestic demand and supply curves for a hypothetical economy.



b) In this hypothetical economy, there was an import quota of 200 000. The government is considering imposing a tariff instead. What is the total tariff revenue generated if the imposed tariff has the same impact on domestic production as the original import quota? **2**

- *Import quota of 200 000 → Tariff price has to equal \$8 → tariff revenue = (8-6) x 200 000 = 400 000*

c) Discuss the costs and benefits of implementing an import tariff instead of a subsidy. **4**

Costs of Tariff:

a. *Decreased competition for domestic industries. Domestic industries are not incentivized by competition to improve technology and productive capacity to maintain profitability. They can become inefficient (overdependence on protection)*
b. *Higher prices for domestic consumers leads to lower material satisfaction and lower utility which can decrease both quality of life and standard or living*

Benefits:

c. *Subsidies increase government spending (fiscal burden) and could lead to a misallocation of resources whereas tariffs generate revenue that can be used in the economy for infrastructure, schools, healthcare etc.*

PEAK Academy

End of Question 24

Section III

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

Your answer will be assessed on how well you:

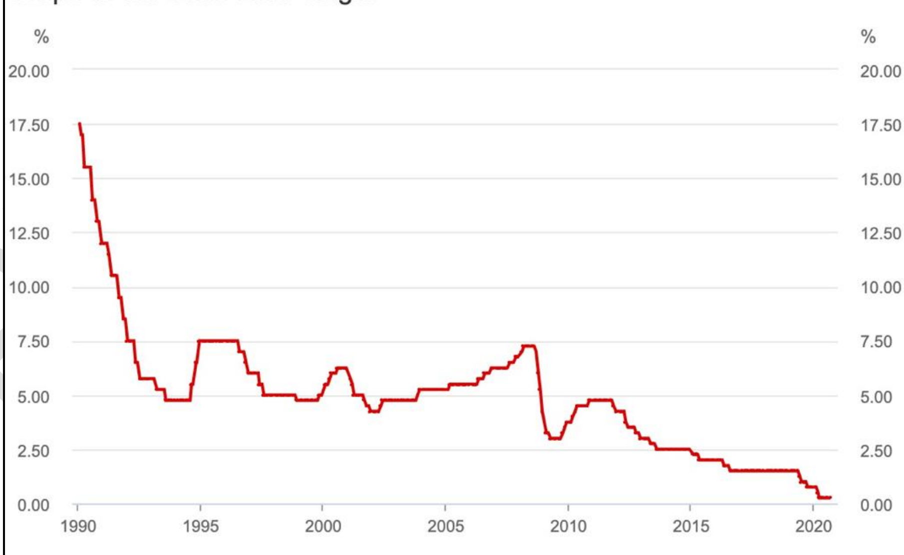
- demonstrate knowledge and understanding relevant to the question
- use the information provided
- apply relevant economic terms, concepts, relationships and theory
- present a sustained, logical and cohesive response

Question 25 (20 marks)

Discuss the use of macroeconomic policies in achieving the Australian government's objectives of economic growth and full employment. **20**

"The Government is providing timely economic support with $289 billion in fiscal and balance sheet measures, equivalent to around 14.6 per cent of GDP. This action, together with large declines in taxation receipts and increases in payments, has seen a major deterioration in the budget position, with estimated deficits of $85.8 billion in 2019-20 and $184.5 billion in 2020-21." – Australian Government, Economic and Fiscal Update 23 July 2020

Graph of the Cash Rate Target



Source: RBA

Sample Introduction: The macroeconomic policies which have been used over the past 12 months in Australia to address the economic objectives of economic growth and full employment are monetary policy and fiscal policy. Monetary policy is undertaken by the Reserve Bank of Australia and involves the Reserve Bank changing the official cash rate in order to influence the cost of money (interest rates) in the Australian economy. Fiscal policy is the government's use of taxation and government expenditure (or both) in the budget to influence economic activity. Whilst both policies have played an important role in the current economic downturn, fiscal policy has become the main policy instrument to address the economic issues arisen as a result of COVID.

Monetary Policy: MP is a countercyclical strategy that is implemented through the conduct of Domestic Market Operations (DMOs), which is the main instrument. This involves the selling and buying of second-hand government securities (SGS) by the RBA with participating financial institutions. It is conducted directly through their exchange settlement accounts (ESAs) where they are required to hold a proportion of their funds with the RBA. The purchase or sale of SGS creates a shortage or surplus of funds in the cash market, affecting the cash rate. This influences the level of economic activity through the transmission mechanism. Furthermore, banks transfer the change in cash rate to commercial interest rates as they seek to maintain profit margins, influencing C and I, thus the Keynesian theory of Aggregate Demand (AD = C + I + G + (X-M)).

In March 2020, the Reserve Bank implemented the first of its cash rate changes, with a decrease to 0.25% (refer to the stimulus material). This was a significant change in the stance of monetary policy with the Reserve Bank adopting an expansionary stance for monetary policy. This stance involved the Reserve Bank buying back government securities, which increased the supply of funds and decreased the cash rate in Australia to lower interest rates to increase AD and hence boost economic activity.

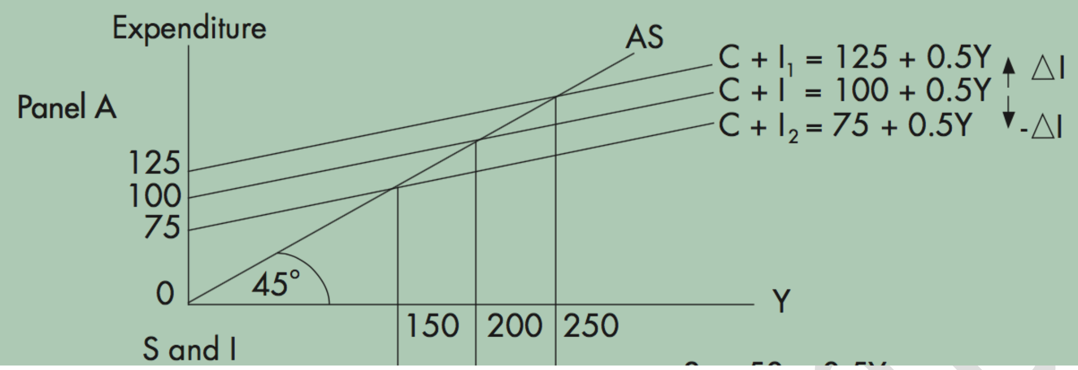
(Note: Better students may include a diagram to show how changes in the cash rate impact on the supply of money.) – Increase in supply graph

As shown in the diagram above, buying SGS increases the money supply from S to S1, increasing the quantity from 0Q1 to 0Q2 which will subsequently lower the cash rate from P to P1. Thus, the cost of borrowing decreases which also reduces domestic interest rates. As such, interest rates have steadily decreased to 0.25%. Consequently, as borrowing becomes cheaper, consumers and business are more likely to borrow for expenditure, leading to an increase in C and I. This increase in AD should theoretically lead to a significant increase in economic growth. Furthermore, this increase in AD should lead to an increase in demand-pull inflation. Furthermore, a boost in economic growth should theoretically allow increased employment and hence reduce cyclical unemployment. However, the unemployment rate has been relatively high, currently around 7%.

Fiscal Policy: Fiscal policy is at the heart of the management of the Australian economy. Fiscal policy is a macroeconomic policy that can influence resource allocation, redistribute income and stabilize the economy. It involves the use of the Federal Government Budget to achieve the government economic objectives of sustainable level of economic growth, price stability, full employment, external stability, distribution of income and environmental sustainability. The budget is the expected revenue and taxation to occur in the next financial year, and by varying taxation and revenue, the government is able to achieve their economic objectives.

PEAK Academy

Figure 7.2: The Multiplier Effect of a Change in Investment on National Income



Fiscal policy can be altered through discretionary changes, which involves direct changes in G or changes in taxation. The government can increase G into the economy to directly change the level of AD in the economy. This was seen throughout 2020 where the Australian government implemented several stimulus packages to counteract the effects of COVID. (list examples and effects to stimulus packages) Thus by initially increasing G, C was increased leading to an overall increase in AD and hence boosting economic growth.

The government can also utilise non-discretionary changes in fiscal policy to stimulate economic growth during a downswing in economic activity. Non-discretionary changes in fiscal policy are the automatic stabilisers in the economy. Automatic stabilisers are policy instruments in the government's budget that counteract the economic activity. This can be seen through an increase in social welfare payments during a downswing in economic activity. These welfare payments are means tested, meaning that they are only given to those who need them, such as pensioners and the unemployed. The main component of fiscal policy in achieving full employment is through discretionary changes. The government of Australia applies discretionary changes in fiscal policy to achieve their goal of full employment. This allows the government to decrease the unemployment rate and achieve their target band of 5-6% rate of unemployment, achieving full employment. Full employment is the desired objective of an economy, as it states the economy is operating at full capacity, theoretically eliminating cyclical unemployment.

PEAK Academy

Question 26 (20 marks)

Use the following stimulus (Speech on Economic Outlook from the Assistant Governor at the RBA) to answer the following question. **20**

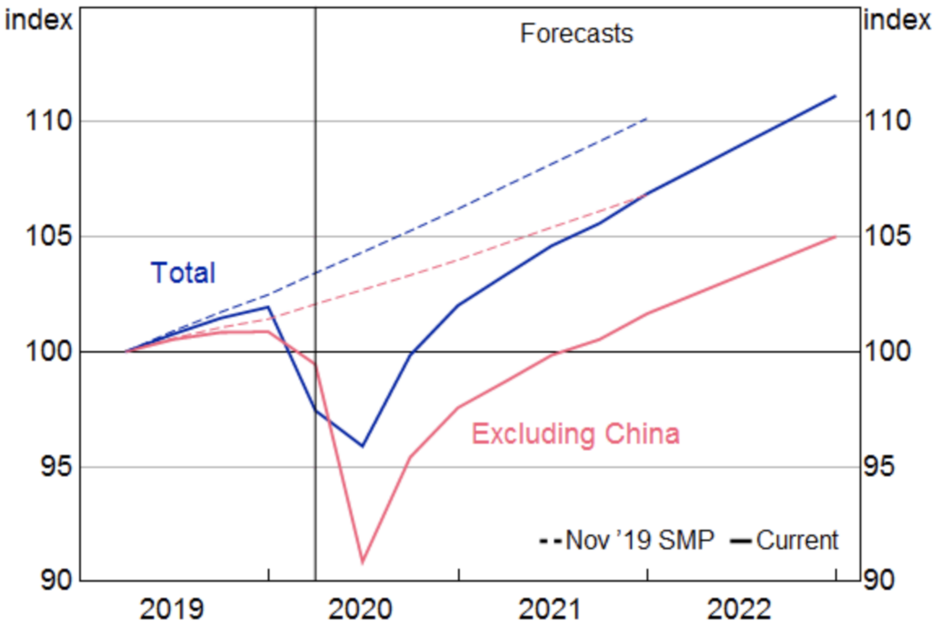
Analyse the impact of changes in the global economy on Australia's balance of payments.

This lingering effect of the pandemic on uncertainty and demand means that, beyond the first couple of months, recoveries will be protracted and uneven. It will take time to get back to the level of global GDP prevailing before the pandemic. Taking 2020 as a whole, global GDP is expected to contract by more than 4 per cent, before rising by nearly 6 per cent in 2021. If realised, this outcome would still leave GDP below where it would have been had the outbreak not occurred. The pattern is very similar for Australia's major trading partners, though the contraction occurred earlier and the recovery is expected to be a bit more vigorous in China than in our other major trading partners (Graph 3; Graph 1.7 in the SMP).

Graph 3

Australia's Major Trading Partner GDP

March 2019 = 100



Sources: ABS; CEIC Data; Consensus Economics; RBA; Refinitiv

Sample Introduction: The balance of payments is a record of all transactions between Australia and the rest of the world during a period of time. Due to increasing globalisation through increased integration and interdependence between economies, changes in the global economy have significant effects on Australia's balance of payments seen through implications on both the current account and capital and financial account. This has subjected us to greater volatility since global shocks, the international business cycle, changes in commodity prices and growth in trading partners, changes in investor and consumer sentiment can impact on trade volumes, capital inflows and capital outflows of the balance of payments. The global uncertainty that has risen due to COVID-19 pandemic has impact trade and financial flows thus sustaining Australia's recent current account surplus despite our historic record of 44 years of current account deficits.

Sample Paragraph: Changes in global growth are a reflection of changes in global consumer and investor confidence and can thus change the level of capital inflows and inflows which influence the size and composition of the balance of payments. The growth of major trading partners is a key factor determining BOGS outcomes. As seen during the global instability and dramatic loss in confidence during the current COVID-19 pandemic, the decline in growth of major trading partners including China for example has impacted Australia's balance of payments through a drastic reduction in exports and capital inflow. As referenced in the stimulus, the forecasted expectation that global GDP will contract by another 4% suggests that the impacts on the balance of payments will be sustained to 2021 at least. The slow forecasted expectation of major trading partners of Australia suggests that the BOGS component of the current account in particular will suffer the impacts of decreased export demand which may only rise from the sharp decline by 2022. However, considering that import levels are also decreasing due to low domestic consumer confidence and lower disposable incomes (due to a multitude of pandemic related job losses), the size of the BOGS component will be decreasing but may still remain in a surplus that contributes to the entire current account surplus. Similarly, during the GFC, where world economic contracted by 0.5% in 2009, decreases in export demand led to the worsening of BOGS. The reduction of FDI and portfolio investment due to uncertainty during this time led to a decreased KAFA surplus. As a result, the reduction in NPY outflows due to lower levels of interest payments such as interest payments contributed to the CAD halving from 6.4% to 3.2%. Over time, Australia's ability to avoid a technical recession of two consecutive quarters of negative economic growth during the GFC contributed to its attraction of investment due to the Safe-haven effect. Since then, despite Australia's relatively low national savings rate, it attracted large levels of investment which was reflected through consistent KAFA surpluses and Current account deficits. This trend has also been observed during the current COVID-19 pandemic where the current account surplus first achieved in 2019 (due to commodity driven demand for exports) has been sustained due to lower levels of FDI and Portfolio investment in particular as most individuals are engaging in precautionary savings rather than actively engaging in economic activity. This proves how changes in the global economy through global shocks has a significant impact on the balance of payments.

(Note: this above paragraph would be broken up into smaller paragraphs but for learning purposes more examples are included)
(Better responses will make consistent references to the question and stimulus).

PEAK Academy

Section IV

20 marks
Attempt either Question 27 or Question 28
Allow about 35 minutes for this section

Your answer will be assessed on how well you:

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

Question 27 (20 marks)

Evaluate the strategies utilised by an economy other than Australia to respond to globalisation and promote economic growth and development. **20**

(Sample Case Study: Ireland)
(Important Note: this case study only models the impacts of ONE strategy on economic growth and development. Better responses will incorporate the impact of at least ONE more strategy employed their chosen economy)

Globalisation refers to the rise in economic integration and interdependency between economies through movements in trade, labour and investment and the emergence of a single world market. Ireland is the fastest growing economy in the European Union as it models the effects of globalisation through its high levels of economic growth; a quantitative measure of a rise in real GDP and improved economic development; a qualitative representation of an increase in well-being and living standards. Though it may have been amongst the most severely impacted by the 2008 GFC and housing bubble collapse, it's firm strategies of trade liberalisation through their EU membership and "industrialisation by invitation" significantly increasing foreign direct investment, aided its post-crisis economic recovery. As a result of these strict policies, Ireland experienced a successful re-emergence, seen through their high forecasted economic growth rate of 4.1% coupled with being ranked 4th in terms of the Human Development Index (HDI), the economy is deemed to be the "Celtic Phoenix".

Economic growth refers to the sustained increase in productive capacity in an economy linking directly to an economy's gross national income. Ireland's currently high level of economic growth can be directly attributed to their integration into European Union (EU) granting them greater access to a larger export market significantly increasing trade flow through the strategy of trade liberalisation .Their EU membership had significant positive impacts on their balance of payments as a small, open market economy that is heavily reliant on exports would otherwise not be able to maintain competitiveness and negotiate trade agreements on a global scale. Through the reduction of artificial barriers to trade (tariffs, and quotas), a level of trade liberalisation enables Ireland to engage in international EU trade agreements such new trade agreements with USA that could potentially increase their GDP by 1.1%. According to the European commission, Ireland's net gain from EU budgets has been 44.6 billion pounds to since 1976, which is a key indicator of how anti-protectionist strategies can effectively promote high eco growth in the long term. However, the

PEAK Academy

effectiveness of Ireland's EU membership is hindered through its negative impacts of loss of national currency sovereignty and increases in volatility and exposure to financial shocks and the detrimental effects of the "financial contagion". This was seen during the GFC coupled with the effects of a property bubble burst during the ESDC in 2010-11, which led to the collapse of the "Celtic Tiger", as Ireland fell into a recession (negative levels of economic growth for two consecutive quarters) which ultimately required the IMF and ECB to hand out a 85 billion pound bailout package to this economy.

The result of integrating into the EU has effectively underpinned Ireland's economic development as the nation stands with an extremely high HDI of 0.938 indicative of high levels of general health, education and standard of living. EU Micro reform such as the 68-million pound Youth Guarantee Initiative to provide jobs, training and education for under 25 year olds not only improves long term economic growth by improving productive capacity, it also generates higher acquisition of skills which can be matched with higher income earning jobs. As observed in 2018 where the u/e rate in Ireland decreased to 5.7% from 6.7% in the previous year, more individuals with higher disposable incomes can correlate to improvements in standard of living (wealth and material comfort) and quality of life (health, comfort and utility). Additionally, as a result of trade liberalisation after entering the EU, Ireland had a greater access to a variety of goods at LOWER PRICES due to reduced tariffs and quotas between member nations, thus reducing consumption costs for individuals. However, similar to economic growth, the effects of the 'financial contagion' where financial crisis can be quickly transmitted through interdependent nations, can pose limitations to economic development. As seen during the Irish financial crisis (2008-11), fiscal budgetary cuts through decreased welfare and increased tax rates were used to offset the impacts of falling into a recession which ultimately led to a 26% decrease in household income. Though this risk of volatility can dampen economic development by affecting rates of poverty, Ireland's integration into the EU has proved itself as being effective as it is a crucial factor in underpinning economic growth and development.

OR

PEAK Academy

Question 28 (20 marks)

Discuss the effects of the global economy on Australia's internal & external stability. **20**

Sample: The global economy affects Australia's internal and external stability through changes in aggregate demand. Internal stability refers to issues concerning inflation and unemployment. External stability refers to the structural component of the current account deficit (CAD); Net Foreign liabilities and Net foreign debt as well as the cyclical components of CAD; the Terms of Trade (ToT), Australia's exchange rate and international competitiveness. Fluctuations in the global economy have a flow-on effect and impact both external and internal components of Australia's economic stability.

Australia's current account deficit (CAD) is largely due to the balance on goods and services (BoGS) deficit or the net primary incomes deficit. A cyclical component of the CAD is the Terms of Trade (ToT) which measures export prices relative to import prices. Changes to the price of Australia's exports, such as fluctuations in world commodity prices, affect the ToT. During the mining investment boom phase II (2010-2012), Chinese stimulus packages provided strong demand for Australian commodities exports, leading to an increase in Australian export prices and hence a ToT increase of 30 index points.

Sunrise industries experience rapid growth whereas, sunset industries experience declining growth levels. In the short-term, Australian exporting sunrise industries such as Rio Tinto and BHP Billiton collected greater revenues due to a high ToT but would lose international competitiveness in the long-term. Sunset industries lost market share and eventually closed down, especially when left unsubsidized such as the Australian car manufacturing industry. Consequently, a high ToT had a negative impact in the long-term as the trade balance deteriorated by 3%, increasing cyclical CAD by 2.5%, creating external instability.

$AUD appreciation: Figure 1

Changes in demand for the $AUD result in exchange rate fluctuations. Due to strong global demand for Australian exports, currency conversions to purchase Australian exports increased as shown by the increase from Q1 to Q2 and henc e increased demand for the $AUD shown by a shift to the right from D1 to D2. Therefore, the $AUD appreciated by 15 index points, shown by an increase from R1 to R2 in figure 1.

The J-Curve: Figure 2

Figure 2 shows that due to the increased $AUD, in the short-term, Australian export prices increased and hence firms collected greater revenue from exports, lowering cyclical CAD. Furthermore, a strong exchange rate reduced Net Foreign Debt by 5% of GDP due to the revaluation effect, lowering structural CAD. However, figure 2 shows that due to increasing export prices, international competitiveness fell in the long-term which lead to a 2.5% deterioration of the trade balance and a 2% increase in the CAD. The A high $AUD reduced international competitiveness and hence created the possibility of a Dutch Disease as manufacturing industries did not sustain profitable revenue. The short-term effects are positive as the CAD improved, providing external stability. However, a high $AUD has negative impacts on international competitiveness in the long-term and therefore is unsustainable in the long run.

Net Foreign Liabilities are made up of Net Foreign debt and Net Foreign equity, representing Australia's outstanding foreign repayments. During the mining investment boom phase II, increased aggregate demand in the global economy meant increased demand for Australia's exports. Consequently, the balance on goods and services (BoGS) improved by 3%, reducing cyclical CAD by approximately 3%. This diminished the need for overseas borrowing, resulting in a 5% decrease in Net Foreign Debt and hence a lower debt servicing ratio. As such, net foreign liabilities decreased by 7%. In effect, the Australian economy was able to offset foreign debt through a strong trade balance. The Pitchford thesis explains that high levels of foreign borrowing are sustainable if invested into productive sectors of the economy. Hence, according to the Pitchford thesis, this has positive implications for the

PEAK Academy

Australian economy as it suggests that foreign borrowing is sustainable and hence on-going economic growth in Australia.

The natural rate of unemployment: Figure 3

The labor force is a vertical line representing the number of unemployed + employed persons. Cyclical unemployment occurs due to reduced derived demand for labor due to decreasing aggregate demand. Structural unemployment occurs due to a mismatch of the skills required for production and skills available in the labor force. The non-accelerating inflation rate of unemployment (NAIRU) is represented by the point E in figure 3, where there is no cyclical unemployment. The gap between E and U represents the natural rate of unemployment which is made up of frictional and structural unemployment only.

The Short Run Phillips Curve (SRPC): Figure 4

The Short Run Phillips Curve (SRPC) - figure 4; shows the inverse relationship between inflation and unemployment. Inflation or the Consumer Price Index (CPI) refers to an increase in the general level of prices for common household goods and services. From 2004-2012, strong global growth sustained demand for labor which absorbed cyclical unemployment, allowing unemployment to remain within the 5-6% range shown by point E in figure 3. As high growth levels have not been sustained, the point A in figure 4 represents the current unemployment and inflation conditions. Slowing growth of Australia's major trading partner; China has led to an average economic growth rate of 2.5%, outside of the government's 3-4% target. This implies low derived demand for labor which cannot absorb all cyclical unemployment, resulting in greater total unemployment and hence lower inflation as shown by the point A in figure 4 instead of point E in figure 3.

Inflation can be categorized as either cost-push or demand pull. Cost-push inflation occurs when higher production costs are passed on to consumers. Demand pull inflation occurs when aggregate demand rises faster than aggregate supply. As unemployment increases due to slowing economic growth, consumption decreases, leading to reduced demand-pull inflation. The current inflation rate is a historical low, 1.3%, outside of the government's 2-3% target and is caused by lower demand-pull inflation. Demand-pull inflation is projected to continue decreasing as unemployment increases. Furthermore, production costs and labor costs are currently relatively low causing lower cost-push inflation. The implications of lower inflation rates are largely positive as low inflationary rates encourage international competitiveness. Subsequently, this encourages economic growth, employment and hence improves external and internal stability.

Evidently, the global economy impacts Australia's internal and external stability through changes in aggregate demand. The global economy fluctuates in a cyclical nature, making it likely that both positive and negative periods of economic growth will continue to impact both cyclical and structural components of the CAD, inflation and unemployment. Hence overall stability in the Australian economy requires a balance of both external and internal stability and is determined by the global economy.

PEAK Academy

End of paper