
YEAR 12 ECONOMICS EXAMINATION

MAY, 2006



Time allowed for this paper

Reading Time before commencing: Ten Minutes

Working Time for paper: Three (3) Hours

There are three Sections to this paper:

SECTION A	Multiple Choice	25 x 1 = 25 marks maximum
SECTION B	Short Answers	3 x 10 = 30 marks maximum
SECTION C	Long Answers	3 x 15 = 45 marks maximum
TOTAL		= 100 maximum

INSTRUCTIONS TO STUDENTS:

Answer the multiple choice section on the sheet provided.

All other questions are to be answered in the spaces provided in the booklet.

Non-graphic or non-programmable calculators are allowed.

SECTION A

Attempt all questions from this section. Choose the alternative answer which correctly answers the question set or completes the statement. Record your answers on the separate Multiple Choice Answer Sheet using a 2B, B or HB pencil. Read the instructions on this sheet with care. Each question is worth 1 mark

1. Which of the following most closely describes the current internal balance of the Australian economy?

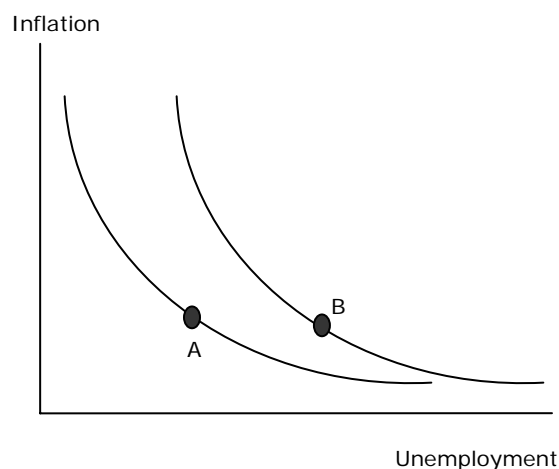
	CPI (% change per year)	GDP (% change per year)	Unemployment rate (%)
A	3	1	3
B	3	3	5
C	5	3	7
D	1	5	7

2. Which of the following is the **LEAST** accurate description of current Government and Reserve Bank economic objectives?

- (a) Ensuring on-going or underlying inflation is about 2% to 3% per year
 - (b) Reducing unemployment to a minimum without triggering inflation, the so-called NAIRU level of about 5%
 - (c) Making sure the level of exports of goods and services equals the level of imports of goods and services
 - (d) Aiming for as much sustained economic growth for as long as possible
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3. The diagram shows the internal balance of an economy has shifted from point A to point B. This change was, everything else being equal, most likely the result of:

- (a) a rise in aggregate demand
- (b) a fall in aggregate demand
- (c) a rise in the natural rate of unemployment
- (d) a rise in cost-push inflation



4. When businesses undertake investment, the effect on the circular flow is similar to that of;

- (a) increases in direct taxation by the Australian Government
 - (b) increases in the marginal propensity to save of households
 - (c) increases in savings by the household sector
 - (d) decreases in the government budget surplus
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5. If the economy is in equilibrium while the government budget is in surplus and exports are less than imports then, according to the circular flow model;

- (a) saving is greater than investment
- (b) saving equals investment
- (c) saving is less than investment
- (d) saving could be greater than or equal to investment

6. In a period of strong economic growth which of the following would most likely be policy priorities of the government?

- (a) price stability and controlling the current account deficit;
- (b) external stability and income distribution;
- (c) full employment and price stability;
- (d) raising economic growth and achieving a sustainable balance of payments.

7. The multiplier process is measured by the:

- (a) amount of the initial increase in aggregate demand caused by a new injection into the economy.
- (b) change in GDP caused by multiple policy changes.
- (c) total amount by which GDP rises after an initial injection.
- (d) change in aggregate supply caused by an initial injection.

8. Which of the following set of circumstances would lead to the smallest change in the level of economic activity in an economy?

	Autonomous change in spending	Marginal propensity to consume
A	Government spending rises by \$15b	0.8
B	Investment spending rises by \$20b	0.7
C	Net exports rise by \$25b	0.6
D	Government spending falls by \$30b	0.5

9. In a closed economy, if $C = \$400m$, $G = \$40m$, $T = \$40m$, $S = \$100m$ and $I = \$80m$, then it is likely that:

- (a) income earned in the next period will fall
- (b) inventories held by firms will decline
- (c) interest rates will rise since consumption is less than income
- (d) the government budget will be in surplus

10. The data in the table shows that:

- (a) The marginal propensity to save is 0.67 and the multiplier coefficient is 3
- (b) The marginal propensity to save is 0.5 and the multiplier coefficient is 2
- (c) The marginal propensity to save is 0.33 and the multiplier coefficient is 3
- (d) The marginal propensity to save is 0.25 and the multiplier coefficient is 4

	Disposable income	Consumption
	\$325	\$325
	\$400	\$375
	\$475	\$425
	\$550	\$475

11. The period between a peak in the business cycle and the subsequent trough

- (a) is a period when planned injections are more than planned leakages
- (b) is generally shorter than the period between a trough and the subsequent peak
- (c) is termed the "upswing or recovery" period of the business cycle
- (d) is a period of rising inflation and falling unemployment

12. Which of the following events are most likely to be associated with a downturn in the economic cycle?

- (a) Investment rises as interest rates fall
- (b) Consumption falls as household income and wealth falls
- (c) The participation rate rises in line with a rise in unemployment
- (d) A significant rise in the value of imports as domestic production falls

13. The table shows changes in the Consumer Price Index and nominal interest rates during a four year period. From the data in the table it can be concluded that real interest rates:

Year	CPI (at year start and year end)	Nominal interest rates
1	150.0 to 157.5	7.00
2	157.5 to 162.2	5.00
3	162.2 to 163.8	3.00
4	163.8 to 168.7	5.00

- (a) fell during years 2 and 3 but rose in year 4
- (b) remained at approximately 2% in all four years
- (c) rose in years 2 and 3 but fell in year 4
- (d) were changed by the Reserve Bank in the response to changes in the inflation rate

14. Which one of the following, everything else being equal, is most likely to cause inflation rates to rise in the Australian economy?

- (a) A rise in labour productivity
- (b) Increased trade liberalisation
- (c) Capacity constraints
- (d) An increase in interest rates

15. Which of the following will tend to increase the impact of cash rate changes in the Australian economy?

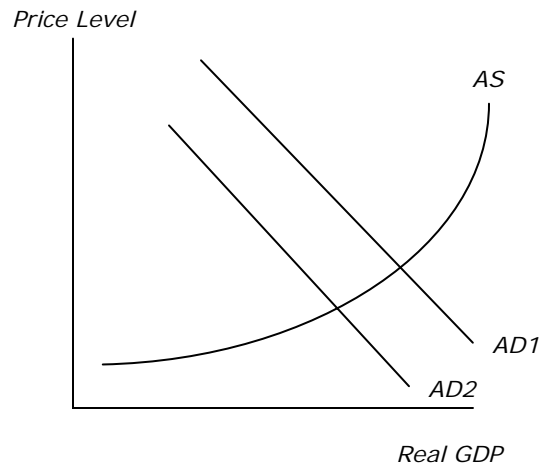
- (a) A buoyant share and property market
- (b) An increase in the level of consumer confidence and expectations
- (c) An increase in the popularity of fixed interest home loans
- (d) An increase in the level of household debt

16. Contractionary monetary policy involves which of the following chain of events?

- (a) RBA raises cash rates, other interest rates rise, consumption and investment fall, aggregate demand falls, demand-pull inflation falls
- (b) Market interest rates rise, RBA increases cash rates, inflation rises, consumption and investment fall
- (c) The Government raises tax and cuts spending, aggregate demand falls, demand-pull inflation falls
- (d) RBA lowers cash rates, other interest rates fall, aggregate demand rises, demand-deficiency unemployment falls

17. In the diagram on the right, a rise in cash rates has caused AD1 to shift to AD2. This drop in aggregate demand is likely to:

- (a) increase demand deficiency unemployment rates but reduce demand pull inflation rates
- (b) increase growth rates but reduce demand pull inflation rates
- (c) increase interest rates further but reduce cost push inflation rates
- (d) increase demand pull inflation rates but lower demand deficiency unemployment rates



18. Real GDP per capita is a poor measure of economic welfare because

- (a) it includes the value of both household and market production
- (b) it is not adjusted for changes in the size of the population
- (c) it is not adjusted for production that causes negative externalities
- (d) it is not adjusted for the effects of inflation

19. Long term, sustained economic growth is essentially:

- (a) a supply-side issue concerning efficiency improvements
- (b) a demand-side issue concerning the level of aggregate demand
- (c) a global issue involving restricting the growth of international trade
- (d) a matter of controlling the twin budget and current account deficits

20. The emphasis of fiscal policy under the Howard Government in Australia has been to:

- (a) increase the level of government spending as a percentage of GDP so that public services and social overhead capital can be improved
- (b) vary the budget outcome for demand management purposes
- (c) reduce the level of public sector debt
- (d) keep interest rates below their 1996 level

21. Changes to income tax rates in the 2006 budget were designed to promote

- (a) both efficiency and equity
 - (b) efficiency rather than equity
 - (c) equity rather than efficiency
 - (d) neither efficiency nor equity
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22. The table shows the size of a Government's budget surplus over four years. In which year or years was the Government's fiscal policy contractionary?

Year	Budget surplus (\$A)
2003-4	10b
2004-5	15b
2005-6	10b
2006-7	5b

- (a) In each year in the table
- (b) In 2004-5
- (c) In 2006-7
- (d) In none of the years in the table

23. Other things being equal, a rise in Australian cash rates from 5.5% to 6% would

- (a) decrease the value of the Australian dollar on foreign exchange markets
- (b) increase the level of investment by the Australian business sector
- (c) decrease household consumption
- (d) increase share and property values and hence increase levels of household wealth

24. If, during the same period, other things being equal, the government decreases its budget surplus and the Reserve Bank raises official interest rates which of the following is most likely to be true?

- (a) The level of growth and rate of inflation will be increased by both policy changes
- (b) GDP will fall because of the decreased budget surplus but inflation will rise because of the increased interest rates.
- (c) GDP will rise because both policy measures will raise the cost of borrowing and lead to more investment in the economy
- (d) Growth and inflation will be largely unaffected because the expansionary impact of the reduced budget surplus will be offset by the rise in cash rates

25. An increase in the size of the budget deficit may not lead to a rise in the level of economic activity because:

- (a) overseas investors will view this as a sign of financial mismanagement and sell some of their Australian dollar securities
- (b) the additional borrowing requirement of the Government may lead to financial crowding out and force up interest rates
- (c) households will save some of their additional disposable income and reduce the size of the multiplier effect
- (d) reduced national savings will lead to a rise in the current account deficit

END OF SECTION A

SECTION C
Extended writing (45 Marks)
Suggested time: 90 minutes
Answer THREE (3) questions ONLY. Each question is worth 15 marks.

Question 29

- (a) Explain the economic meaning of the term 'injection'. What kinds of injections are there in the Australian economy? (6 marks)
- (b) Explain why such an injection may lead to a more than proportionate increase in the level of real output. (9 marks)
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Question 30

- (a) Describe the relationship between growth and unemployment. (7 marks)
- (b) To what extent may the pursuit of lower unemployment conflict with other economic objectives? (8 marks)
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Question 31

- (a) Describe the Australian Government's medium term budgetary (fiscal policy) strategy and the reasons for adopting this strategy. (7 marks)
- (b) Analyse the extent to which changes in the May 2006 budget conform to the principles of taxation. (8 marks)
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Question 32

- (a) Describe the impact on the Australian economy of a rise in Australian cash rates. (7 marks)
- (b) Describe why the Reserve Bank raised cash rates in May 2006 and the likelihood of the Reserve Bank Board increasing interest rates again in the next few months. (8 marks)
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END OF QUESTIONS