Practice Half Yearly Examination

Multiple Choice

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

Short Answers

Question 21

(a) One benefit of a floating exchange rate is that market forces of supply and demand freely determine the value of a nation's currency. As a result, the prices for exports and imports respond quickly to changing economic conditions, creating greater flexibility and dynamic efficiency. However, a floating exchange rate is also susceptible to large and sudden fluctuations in its value, due to speculation in foreign exchange markets. Such volatility creates uncertainty for investors, discouraging longer term business investment.

(b) As can be seen in the stimulus, since around 2000 the improvement in the terms of trade index has been associated with an appreciation of the Australian dollar. When the terms of trade increases this means that export prices are rising faster than import prices. As such, foreign purchasers who wish to buy Australian exports need to buy more Australian dollars, increasing the demand for the Australian dollar and leading to an appreciation.

(c) In the 2000s Australia's terms of trade significantly improved, primarily because of the sharp increase in the global prices of commodities such as coal and iron ore, which Australia exports. Over the same period, prices for manufactured goods, which Australia tends to import, declined, also improving the terms of trade. In 2010-11, as strong growth in Asia fuelled the global demand for commodities, Australia's terms of trade reached record highs.

(d) An improvement in Australia's terms of trade indicates that export prices are increasing relative to import prices. This means that if output is the same, export revenue will rise and import spending will fall, causing an improvement in the balance on goods and services (BOGS). At the same time, an increase in the terms of trade boosts profits in Australia's mining sector, leading to an increase in dividend outflows and a deterioration in the net primary income deficit. An improvement in the terms of trade can also lead to a phenomenon known as 'Dutch Disease', where the rising terms of trade (driven by a boom in one industry, such as mining) causes an appreciation of the exchange rate. This appreciation reduces the international competitiveness of Australia's other sectors (such as agriculture or manufacturing), partially offsetting the benefits of higher mining exports with lower exports in other sectors and increased imports.

Question 22

(a) Advanced economies have a high GDP per capita and a high level of economic development. Examples include the United States and Australia. By contrast, developing economies have low living standards and poor economic development, and are often reliant on foreign aid and assistance. Examples include Ghana and Laos.

(b) One recent trend in the global economy was the sharp downturn in global growth due to the global financial crisis, as seen in the graph. In 2009 the global economy contracted, with advanced economies experiencing a sharp recession and many emerging and developing economies also experiencing slower growth. This was due to the fall in global trade and investment flows following the collapse of the US sub-prime mortgage market. A second trend that can be seen in the graph has been the difference in growth rates between advanced and emerging and developing economies. Since 2000 the global economy has experienced multispeed growth, with industrialising economies such as China and India driving global growth and experiencing rising trade and foreign direct investment inflows. By contrast, advanced economies have experienced weaker growth, especially since the global financial crisis due to financial market instability, high unemployment and high levels of debt following bank bailouts.

(c) Globalisation has allowed some countries to enjoy higher rates of economic growth. Increased global trade flows have allowed emerging and advanced economies to export according to their comparative advantage. Higher export revenue is an injection that boosts economic growth. Foreign direct investment (FDI) flows are also an injection, and allow skills and technology to be transferred between economies. Globalisation was one of the reasons for the upturn in the global economy in the mid 2000s, as seen in the graph. However, developing economies have largely been excluded from many of the benefits of globalisation – for example, due to discriminatory trade agreements amongst advanced economies. The globalisation of trade, finance and investment also makes an economy more exposed to a downturn in the international business cycle, such as the sharp fall in global growth that occurred in 2009, as seen in the graph.

Question 23

(a) Increased trade flows allow developing economies to earn export revenue by selling goods and services to overseas markets. This leads to rising domestic income levels that can be used to fund improvements in health, education and environmental standards.

(b) The shifting economic weight towards low and middle income countries, especially in Asia, has been mirrored in changes in Australia's trade patterns. Rising growth and living standards in industrialising economies in Asia have increased the share of Australia's export revenue coming from these economies, including the economic giants China and India which have had strong demand for Australia's mining and energy commodity exports to fuel the process of industrialisation. At the same time, Australia's exports to the European Union and the United States have declined over time. The specialisation of emerging economies in low-value added manufacturing has seen these economies make up a growing proportion of Australia's import expenditure. China is now Australia's largest trading partner.

(c) China is an example of an emerging economy that has experienced the benefits of increased trade, investment, financial, technology and labour flows during the globalisation era. Since the 1980s China has undergone a transition from being a centrally planned economy to become a more open capitalist economy though still with high levels of state ownership. China has engaged in a trade liberalisation program that has seen reduced trade protection, as well as its participation in global trade agreements such as the World Trade Organisation. The Chinese government has fostered the development of large-scale manufacturing and export-led development through the creation of Special Economic Zones. The government has reduced barriers to foreign direct investment inflows and relaxed restrictions on transnational corporations operating in China. However, the Chinese government still retains a high level of ownership of many state-run enterprises and assets. In response to a downturn in the international business cycle in 2009, the government implemented a largely successfully fiscal stimulus package to boost domestic growth and investment.

Question 24

(a) With the imposition of the tariff, domestic producers supply a greater quantity of the good. As a result, imports decrease from 8,000 units to 4,000 units, after the tariff is imposed.

(b) Producer revenue before tariff = 10,000 x $55

= $550,000

Producer revenue after tariff = 12,000 x $60

= $720,000

Change in producer revenue = $720,000 – $550,000

= $170,000

(c) Protection improves the competitiveness of domestic producers, increasing the demand for domestically produced goods, creating local jobs and shielding domestic employment. On the other hand, protection distorts the allocation of resources in an economy towards protected industries and away from those where resources are used most efficiently.

(d) An increase in global protection reduces Australia's access to overseas markets and leads to lower export earnings. As a result, Australian exporters are made less internationally competitive, reducing their income and Australia's total output. For example, the European Union Common Agricultural Policy provides European farmers with an artificial advantage over their Australian competitors.

(e) Bilateral and multilateral (or regional) trade agreements have reduced protectionist barriers between member countries and increased trade flows. However, regional trading blocs that are closed or discriminatory mean that non-member countries still face barriers to market access. For example, the European Union's Common External Tariff and the Common Agricultural Policy restrict non-member countries from accessing European markets. Some economists argue that regional and bilateral trade agreements are an important 'stepping-stone' to global free trade, because they demonstrate the benefits of trade liberalisation for countries on a smaller scale. However, critics argue that discriminatory trade agreements only divide the global economy into independent trading regions, hindering attempts at further economic integration.