

# *Creative Economics - Study Guide*

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**DETAILED PLAN**

## Structure 1 🖱

**DETAILED PLAN:****Introduction**

- Paragraph 1 Overview of exchange rates.  
Paragraph 2 Overview of effects.

**Part 1: Appreciation**

- Paragraph 3 Lower inflation.  
Paragraph 4 Lower international competitiveness, despite lower inflation.  
Paragraph 5 Less tourism to Australia.  
Paragraph 6 Lower foreign debt.

**Part 2: Trade**

- Paragraph 7 Overview of the effects of a depreciation.  
Paragraph 8 Higher inflation from higher import prices.  
Paragraph 9 Better international competitiveness so higher export receipts.  
Paragraph 10 More tourism to Australia.

**Part 3: CAD**

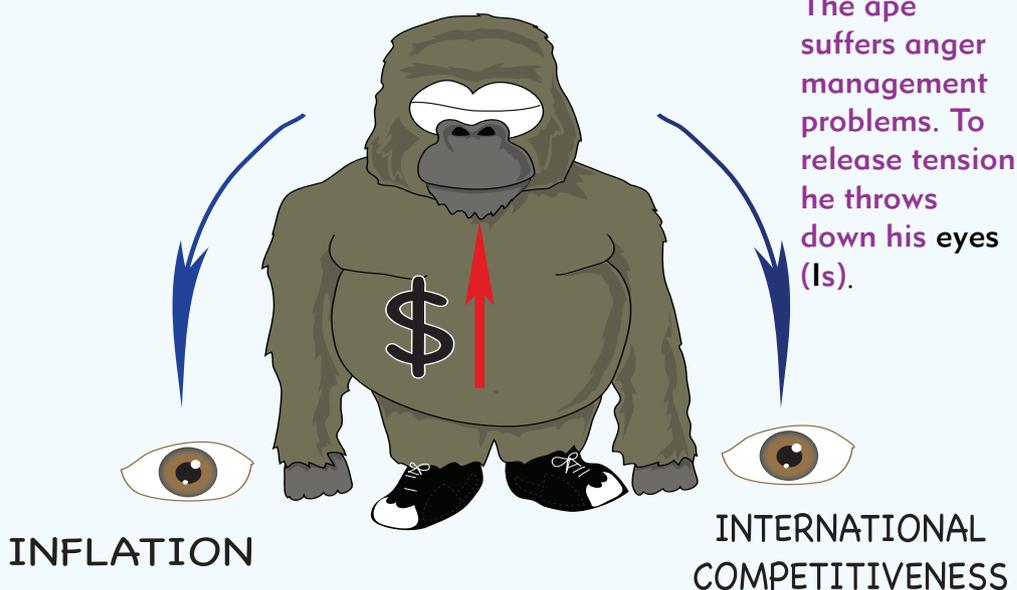
- Paragraph 11 CAD will improve because of more exports.  
Paragraph 12 CAD improves - higher financial flows and valuation effect.  
Paragraph 13 J-Curve.  
Paragraph 14 Valuation effect will also increase value of foreign debt.

**Part 4: Domestic Objectives**

- Paragraph 15 Economic growth.  
Paragraph 16 Flow-on. Lower unemployment. Income & Expenditure and Employment diagrams.  
Paragraph 17 Lower terms of trade because of higher import prices.  
Paragraph 18 Imports can be replaced domestically.  
Paragraph 19 Potential need for contractionary policies.

**Conclusion**

- Paragraph 20 Summary of answer.

**CREATIVE STRUCTURE - OPTIONAL (This structure may assist you):****Structure 1: Ape Story - impact of an appreciation**

## Explain the effects of fluctuations in the value of the Australian Dollar.

### Detailed answer

#### Techniques for constructing the paragraphs

**FOCUS:**  
Examiner's 'key word' - 'Explain'

**FOCUS:**  
Information:  
Overview of the essay

### Introduction:

In explaining the effects of fluctuations in the value of the Australian Dollar (AUD), it is necessary to show how such changes impact the economy. An exchange rate is the price of one currency in terms of another, usually quoted as a country-to-country measurement or using the broader Trade Weighted Index. Currency is traded on the foreign exchange market, forming the backbone of the global economic system. This facilitates trade and financial transactions, as well as speculation which now accounts for some 95% of transactions. Australia, like almost all advanced economies, has had a floating exchange rate since 1983. This means that the price of the currency is determined almost entirely by free-market forces.

As a result, the exchange rate is prone to fluctuations. It may rise or fall quite dramatically. An appreciation or depreciation has profound effects on the economy. It affects the international competitiveness of firms and the purchasing power of individuals, and affects government objectives such as external stability and low inflation.

**FOCUS:**  
Information:  
Definition

**FOCUS:**  
Information:  
Name of a respected economist to add credibility

**FOCUS:**  
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Prepared unit of work that is common to many essays - Padding out the answer

**FOCUS:**  
Information:  
Examples to support your argument

### Part 1: Appreciation

An appreciation occurs when the dollar is more valuable relative to other currencies. Consumers' purchasing power rises, which means that they can buy more imports with Australian dollars. In other words, imports become relatively cheaper. This means that imported inflation falls. As Glenn Stevens, the Governor of the Reserve Bank of Australia (RBA), said, an appreciation "assists to keep inflation under control by lowering prices for tradeable goods and services". It can also lower cost inflation by reducing the price of imported inputs of the production process.

The international competitiveness of Australian firms will nevertheless fall because of a stronger dollar. Cheaper imports mean that costs of production will fall, which is usually associated with better international competitiveness. However, this is offset by the increase in the relative price of Australian exports. Exports therefore decline, which not only harms those firms, but worsens the Current Account Deficit (CAD). In fact, a strong Australian dollar has been cited as one reason for Australia's poor CAD performance for much of the 2000s.

Similarly, tourism will fall. This sector is particularly susceptible to exchange rate fluctuations. An appreciation means that it costs more for foreigners to travel to Australia. Given Australia's relative geographical isolation, this greatly affects tourism levels. Qantas Group Sales and Distribution Manager Rob Gurney attributed slower tourist growth at least partly to the fact that since 2001 the AUD had appreciated 65% against the Yen. This also harms the CAD, and can be particularly devastating because tourism is one of Australia's main services exports (along with education).

On the other hand, foreign debt will fall. A stronger Australian dollar means that the value of debt held in foreign currencies falls in terms of the AUD. This is called the valuation effect, and can help achieve external stability. Debt servicing costs also fall.

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Overview of this  
section

**FOCUS:**  
Information:  
Quotation to support  
your argument

Internet time! Visit:  
RBA – Appreciation  
of Australia’s  
real exchange  
rate: causes and  
effects <http://www.rba.gov.au/econ-compet/2010/pdf/first-year.pdf>

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essays - Padding out  
the answer

**FOCUS:**  
Information:  
Buzz words

### Part 2: Trade

A depreciation of the dollar on the whole tends to have a more positive effect on the economy, although some sectors and some objectives, especially price stability, will be harmed. It affects trade and external stability, with immediate implications for domestic economic performance.

A weaker Australian dollar leads to higher inflation. Imported inflation rises because foreign goods become relatively more expensive. This has second-round effects. Cost inflation also rises because some inputs to the production process are imported, so production becomes more expensive. As Ross Gittins wrote, a depreciation is, simply, “bad for inflation”. Oil, sold both as an (imported) finished good to consumers as petrol, and a vital factor of production, epitomises this double inflationary effect.

On the other hand, international competitiveness for Australian firms will rise. As Australian goods are relatively cheaper in the world market, foreigners will buy greater quantities. Exporting firms benefit directly, and this has flow-on effects for the economy’s external stability. It can also lead to expansion by Australian firms, boosting employment levels. In the 1990s, particularly, export volumes were boosted by a relatively low exchange rate.

Similarly, tourism to Australia will rise. Foreigners enjoy greater purchasing power, so are more likely to visit. This has a positive effect for the Services account of the Current account. Indeed, tourism is vital to the strong performance of this account, and so the impact on the CAD can be considerable.

### Part 3: CAD

All in all, Australia’s CAD is likely to improve because of a depreciation. A weaker Australian dollar boosts exports, both for goods and for services. This is particularly the case for tourism. This reduces the size of the CAD.

Also, the CAD will improve because of increased financial flows to Australia. This will improve the performance of the Primary Incomes account, which is perennially the major structural problem of the Current account, usually contributing a deficit of 3-4% of Gross Domestic Product (GDP). Also, Australia’s external position will be boosted because the valuation effect will make existing foreign assets and earnings relatively more valuable.

In the short-term, though, the CAD will worsen. Demand for imports and exports takes time to adjust to price changes. At first, a weaker Australian dollar will simply mean more is spent on imports and exports earn less. In the medium- to long-term, though, demand will adjust, so there will be fewer imports and larger export volumes, improving the CAD. This pattern is called the J-Curve effect. The Marshall-Lerner Condition, though, states that this will only occur if demand for imports and exports is relatively price elastic. If it is not, a depreciation could in fact worsen the CAD.

However, also due to the valuation effect, Australia’s foreign debt will become relatively more expensive. Similarly, debt servicing costs rise, and this could contribute to external instability. If debt servicing payments become very expensive, there is the danger of a debt trap or a debt cycle, whereby the country has to borrow more, that is, incur new debt, simply to pay the interest on existing debt.

### Part 4: Domestic Objectives

A depreciation is likely to have an expansionary effect on the domestic

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Overview of this section

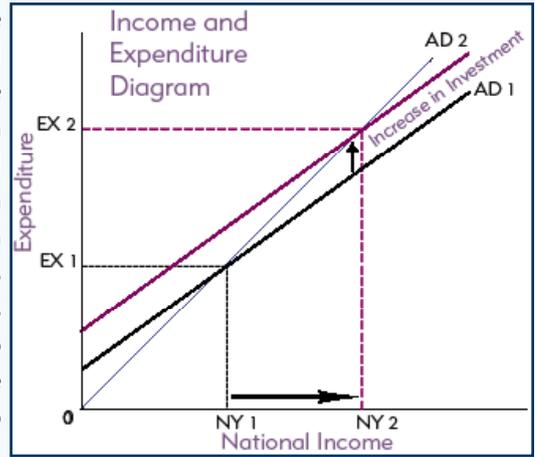
**FOCUS:**  
Information:  
Diagram & explanation  
Income & Expenditure  
Employment

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essays - Padding out  
the answer

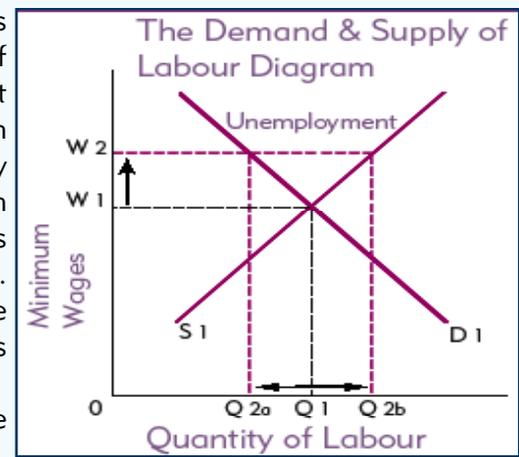
**FOCUS:**  
Recapping your  
essay

economy. The rise in net exports, as export volumes rise while imports fall, will add to aggregate demand, fuelling growth. The increased demand for Australian exports brings money into the country, and stimulates domestic economic activity.

By extension, this causes a fall in unemployment levels. Employment is a derived demand of growth, because when the economy expands and production rises, more workers are needed. This is demonstrated in the Income and Expenditure and Employment diagrams. A rise in aggregate demand fuels growth in national income, which corresponds to a fall in unemployment. This has further flow-on effects, leading to higher wages as workers gain more bargaining power and are able to demand better conditions.



On the other hand, Australia's terms of trade will fall. The terms of trade is an index measuring export prices relative to import prices. In other words, it measures how many imports can be bought for a given volume of exports, and a fall is often linked with a worsening CAD. However, because it measures the price and not volume of trade, this is not always the case.



Indeed, if many imports can be replaced by domestic production, higher import prices should not have a significant impact on the economy. This would dampen imported inflationary pressures, and help the CAD. However, demand for imports will not disappear entirely, so a depreciation will always threaten to undermine both internal and external stability to some extent.

Finally, a depreciation may cause the government to adopt a contractionary stance. If economic growth is excessive, problems such as inflationary pressures, as well as external instability, environmental degradation, and rising inequality occur. This is indicative of the difficulty the government has in striking a balance between its economic objectives. The government may have to take policy measures to dampen growth, such as tighter fiscal and monetary policy, indicated by higher taxes and less government spending, and higher interest rates respectively.

**Conclusion**

Floating exchange rates are prone to constant and, at times, dramatic fluctuations. These changes have important and far-reaching effects for the Australian economy. They affect the competitiveness of firms and purchasing power of individuals, and in this way affect issues such as economic growth, inflation, and external stability.

Explain the impacts of lower protection.

**PLAN ONLY**  
**STYLE:**  
**EFFECTS**

**CHARACTERISTICS OF THIS SPECIFIC QUESTION:**

<b>Style</b> of the question?	Impacts	(effects)
<b>Tense</b> of the question?	Future	(likely effects)
<b>Direction</b> of the question?	Lower	(fall)
Is the question <b>general</b> ?	General	(international and domestic)

**TACTICS**

**SCAFFOLDING THE ESSAY:**

**The main scaffold of this essay:**

Reducing protection has important implications for many different groups within the economy. It affects firms, individuals, the government's economic objectives and, as a result, its policy decisions.

**Secondary scaffolds:**

You will need to be familiar with reasons for protection, such as the infant industry argument, and the range of protectionist policies, such as tariffs and subsidies.

Changing the level of protection will have substantial implications for inflationary pressures, so you must know the types of inflation, especially imported and cost inflation.

You must also know the components of the Current account, because protection affects Australia's external stability.

The impact on government goals will be varied due to the conflicts between objectives.

**INPUTS TO**  
**MAKE YOUR**  
**ANSWER**  
**MORE**  
**DETAILED**

**OPTIONAL INPUTS TO MAKE YOUR ANSWER MORE DETAILED:**

**Buzz words:**

International competitiveness, comparative advantage

**Economic analysis:**

Lower tariffs cause less imported inflation

**Names / quotes:**

David Ricardo, NATSEM Report, Economist, Department of Foreign Affairs

**Diagrams:**

Income & Expenditure and Employment diagram, Phillips Curve

**Complex issues:**

- ➔ Reducing protection causes resources to be reallocated in the economy. This necessarily means that some groups will benefit, and some will suffer.
- ➔ Reducing protection enhances the process of globalisation.
- ➔ There may be short-term problems, but the long-term result should be positive.

**MINI PLAN**

**MINI PLAN:**

<b>Introduction</b>		2 paragraphs	4 minutes
<b>Part 1</b>	Firms	6 paragraphs	12 minutes
<b>Part 2</b>	Individuals	4 paragraphs	8 minutes
<b>Part 3</b>	Government objectives	4 paragraphs	8 minutes
<b>Part 4</b>	Government policies	3 paragraphs	6 minutes
<b>Conclusion</b>		1 paragraph	2 minutes

**DETAILED PLAN:****Introduction**

- Paragraph 1 Overview of protection.  
Paragraph 2 Overview of the effects of lowering protection.

**Part 1: Firms**

- Paragraph 3 Exporters will benefit from reduced protection globally.  
Paragraph 4 They will expand, and can achieve economies of scale.  
Paragraph 5 Domestic firms will be forced to innovate, and will hopefully become more efficient and productive.  
Paragraph 6 Lower costs of production.  
Paragraph 7 Not all firms will be able to adapt and be competitive.  
Paragraph 8 Entire sectors might collapse.

**Part 2: Individuals**

- Paragraph 9 Long-term lower unemployment so higher wages.  
Paragraph 10 Short-term higher unemployment so lower wages.  
Paragraph 11 Inequality will worsen.  
Paragraph 12 Standard of living will rise as consumers benefit.

**Part 3: Government objectives**

- Paragraph 13 Economic growth.  
Paragraph 14 Lower unemployment. Inc & Exp and Employment diagrams.  
Paragraph 15 Short-term CAD problems, but hopefully long-term stability.  
Paragraph 16 Lower inflation.

**Part 4: Government policies**

- Paragraph 17 Increased spending.  
Paragraph 18 Potential need for contractionary stance.  
Paragraph 19 International political closeness.

**Conclusion**

- Paragraph 20 Summary of answer.

**INTERNET RESOURCES:**

- ✎ Department of Foreign Affairs and Trade - <http://www.dfat.gov.au/trade/ftas.html>. Overview of Australia's trade agreements.
- ✎ Australian Customs and Border Protection Service - Working tariff page - <http://www.customs.gov.au/site/page5663.asp#tariff490>. Information on the tariffs imposed by Australia.
- ✎ WTO Statistics Database - Australia Trade Profile - <http://stat.wto.org/TariffProfile/WSDBTariffPFView.aspx?Language=E&Country=AU>. Overview of Australia's tariff and trade profile.
- ✎ Department of Foreign Affairs and Trade - About Australia - [http://www.dfat.gov.au/facts/global\\_trader.html](http://www.dfat.gov.au/facts/global_trader.html). Overview of Australia's trade performance.
- ✎ The Australian - \$6.2bn car subsidy to stay, by Sid Maher - <http://www.theaustralian.com.au/news/nation/bn-car-subsidy-to-stay/story-e6frg6nf-1225822319027>. Article about car subsidies.
- ✎ Reuters - Japan and Australia warn on "Buy American," protectionism - <http://www.reuters.com/article/idUSTRE5142SM20090205>. Article about protection around the world.
- ✎ Washington Post - Trade Wars Brewing In Economic Malaise, by Anthony Faiola and Lori Montgomery - [http://www.washingtonpost.com/wp-dyn/content/article/2009/05/14/AR2009051404241\\_pf.html](http://www.washingtonpost.com/wp-dyn/content/article/2009/05/14/AR2009051404241_pf.html). Article about US protection.

## Explain the impacts of lower protection.

### Detailed answer

#### Techniques for constructing the paragraphs

##### FOCUS:

Examiner's 'key word' - 'Explain'

##### FOCUS:

Information: Overview of the essay

### Introduction:

When explaining the impacts of lower protection, it is necessary to relate the causes and effects of such policy. David Ricardo's theory of comparative advantage underpins the philosophy of globalisation. Ricardo argued that all countries benefit if they specialise in the production of products in which they have a comparative advantage, and traded for the rest. For this to be viable, globalisation must occur; that is, barriers to investment, technology, finance, labour, and especially trade must be reduced. As a result, the global level of protection has steadily fallen. The worldwide average tariff level was, according to The Economist, 26% in 1986 and only 9% now. Australia has epitomised this trend, as average tariffs have fallen from 25% in 1980 to, currently, about 3%. Lower protection worldwide, and particularly domestically, will have wide-ranging and uneven effects. Some firms benefit, as they are able to adapt to international competition. Others suffer, so in the short-term objectives like growth and low unemployment may be undermined. The long-term effects, though, should be positive, as the economy undergoes positive structural change.

##### FOCUS:

Information: Overview of this section

##### FOCUS:

Information: Buzz words

### Part 1: Firms

Exporting firms benefit from the global trend towards lower protection. They have greater access to international markets and are better able to compete abroad. This boosts their profitability. The European Union (EU) Single Market, for example, has in excess of 500 million people, offering firms economic opportunities far beyond the Australian domestic market.

Moreover, these firms can expand their operations. As they become more profitable, they increase the size of their productive output. This allows them to achieve economies of scale, whereby the per unit cost of production falls as the company's size increases. Lower production costs boost international competitiveness, further ensuring and enhancing the firm's long-term profitability. Also, as these firms grow, they attract more foreign investment. Furthermore, reduced domestic protection forces positive change within some companies. As protection levels fall, Australian firms operating in the domestic market face stiffer competition from foreign producers who become able to offer lower cost goods. To compete, these Australian firms must innovate and alter their production process to become more efficient and productive. This gives them better profitability in the long-term, and perhaps grants them the ability to also compete in foreign markets. The Department of Foreign Affairs, for example, estimated that for every 1% fall in tariff levels, there will be a corresponding rise in productivity of 0.3%.

Moreover, this has flow-on benefits for the entire economy, even for sectors not directly impacted by protection cuts. Firms undergoing positive structural change may, for instance, provide capital goods, so this will cause costs of production for other sectors to fall, helping them to boost their international competitiveness and productivity. On the other hand, the influx of cheaper foreign products may provide the same benefit. For example, cuts in Australian manufacturing tariffs have granted mining firms access to cheaper inputs.

However, not all firms successfully adapt to reduced protection. As strong international competition rises, not all firms are able or willing to innovate and change in time. This is particularly the case in sectors in which Australia does not naturally have a comparative advantage. As a result, they lose market

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common to many  
essays - Padding out  
the answer

share and suffer lower profits. Also, new industries are unlikely to emerge and prosper domestically, because these so-called infant industries are unable to compete with established international competition.

In fact, some sectors face severe decline and may even wholly collapse. Domestic firms may succumb entirely to international competition. In Australia, this has proven particularly true for sectors heavily reliant on unskilled labour, such as consumer electronics, as they have been unable to compete with the vast, low-cost workforces of China and other emerging economies.

**FOCUS:**  
Information:  
Overview of this  
section

### Part 2: Individuals

As Australian firms expand globally and become more competitive domestically, the result should be, in the long-term, economic growth. As these firms expand, they require a greater supply of labour, so unemployment will fall. As a result, wages can be expected to rise. When unemployment is low, it means that available workers are relatively scarce, so workers are in a stronger bargaining position to demand better working conditions.

However, in the short-term, structural unemployment will rise. This occurs when the skills of the unemployed do not match those that are being demanded by firms. Some firms and sectors decline as a result of lower protection, so more people will be out of work, and they cannot immediately find a new job. Someone working in consumer electronics cannot, for instance, change immediately to mining. This means that in the short-term unemployment rises, limiting the bargaining power of workers to demand better wages. Over time, though, labour should be reallocated to growth sectors, boosting employment.

Inequality in the distribution of income also worsens. The benefits from lower protection are uneven. In Australia, for example, skilled workers have benefited more than unskilled workers. This has widened the gap between rich and poor. The richest 50% of the population owns 95% of the nation's wealth, and a 1998 NATSEM report warned of the emergence of an "underclass". Also, benefits can be geographically uneven. Australia even has something of a 'dual economy', whereby Western Australia, buoyed by the commodities boom, has grown much more quickly than the rest of the country.

Consumers will have access to more goods. They can choose from a wider variety of products from all around the world. The heightened competition causes prices to fall and hopefully encourage better quality products and better customer services, so, in this way, domestic living standards rise.

**FOCUS:**  
Information:  
Definition

**FOCUS:**  
Information:  
Reference to a  
report that supports  
your argument

### Part 3: Government Objectives

In the long-term, the economy will grow, which is a central economic objective. As Australian firms expand internationally and domestically, becoming more efficient and productive, they boost the economy's productive capacity, signalled by increased GDP. This also attracts foreign investment, fuelling further growth. Reduced protection and globalisation have been significant factors in Australia's strong growth record, boasting almost 20 years of continuous expansion since 1991.

Employment will also rise in the long-term. It is a derived demand of production, because as the economy is producing more, firms need to hire more people. This is demonstrated by the Income and Expenditure and Employment diagrams, which show that a rise in the national income corresponds to a fall in unemployment. In the short-term, however, structural unemployment will rise

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Diagram &  
explanation  
Income &  
Expenditure  
Unemployment

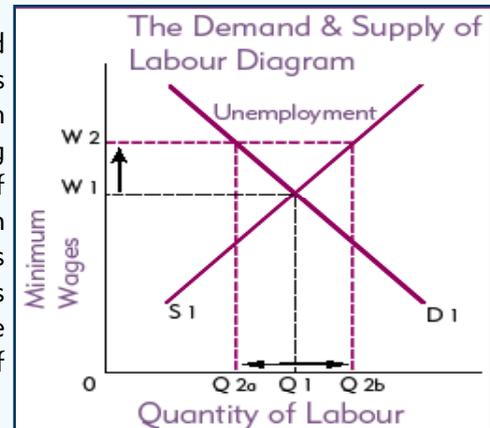
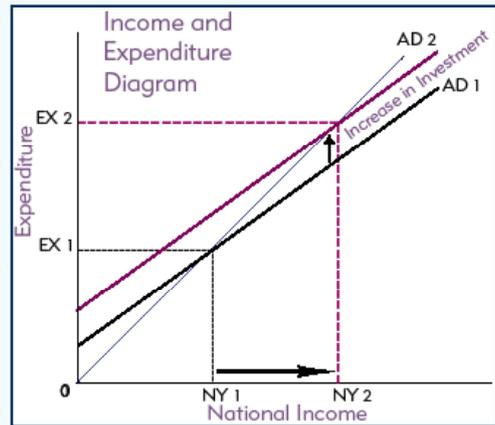
Internet time! Visit:  
The Impact of  
Globalisation on the  
Australian Economy  
(Paper – Anthony  
Stokes)

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of work that is  
common to many  
essays - Padding out  
the answer

as some people lose their jobs because of increased competition.

Similarly, in the short-term, the Current Account Deficit (CAD) may worsen. Consumers have greater access to cheaper foreign goods, so imports rise. This counts as a deficit on the Goods section of the Current account. In the long-term, however, as Australian firms adapt in the domestic market and expand in export markets, the CAD will hopefully decrease because of an improved trade balance.

Overall, reduced protection should help price stability. Inflationary pressures throughout will be dampened. Foreign goods should become cheaper, causing imported inflation to fall. Also, costs of production for Australian firms fall, with access to cheaper inputs, which reduces cost inflation. Cost inflation also falls as domestic firms are forced to innovate and become more efficient in the face of foreign competition.



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Overview of this  
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#### Part 4: Government Policies

A fall in protection levels has important implications for government policy. On one hand, revenue from protectionist measures such as tariffs will fall, although their importance is negligible, comprising only about 1.5% of total government revenue. Conversely, the government has to increase spending to help the newly structurally unemployed and to assist struggling industries to adjust. The Australian government, for example, has a decade-long program to help the textiles industry.

Moreover, if the result of lower protection is, as intended, economic growth, the government may have to respond with contractionary policies. Macro policies must be counter-cyclical, because rapid economic growth could become excessive, causing internal and external instability. Strong growth and low unemployment could result in higher inflation, The RBA may have to tighten monetary policy by raising interest rates and fiscal policy may have to be tightened with reduced government spending and increased tax collection. There are also important foreign policy outcomes. By enhancing globalisation, international economic interdependence is encouraged. This forces governments to co-operate more and may engender greater political closeness.

**FOCUS:**  
Recapping your  
essay

#### Conclusion

Lower protection has wide-ranging effects. In the long-term, objectives like economic growth should be boosted as Australian firms expand internationally and innovate domestically. More efficient and productive companies also increase living standards, and international interdependence encourages political co-operation. Some firms and sectors will not adapt, though, which may cause short-term problems.

**Assess the causes of stronger economic growth.**

<p><b>PLAN ONLY</b> <b>STYLE: CAUSE</b></p>	<p><b>CHARACTERISTICS OF THIS SPECIFIC QUESTION:</b></p> <p><b>Style</b> of the question? Cause (cause)  <b>Tense</b> of the question? Past/Future (past and possible causes)  <b>Direction</b> of the question? Stronger (higher)                  Is the question <b>general</b>? General (not stated)</p>																								
<p><b>TACTICS</b></p>	<p><b>SCAFFOLDING THE ESSAY:</b></p> <p><b>The main scaffold of the essay:</b>                  Growth is caused largely by government policies that affect both aggregate demand and aggregate supply. External forces of globalisation and natural factors are also important.</p> <p><b>Secondary scaffolds:</b>                  You will need to explain how government policies cause growth, and what global actions or bodies also affect Australian growth.</p>																								
<p><b>INPUTS TO MAKE YOUR ANSWER MORE DETAILED</b></p>	<p><b>OPTIONAL INPUTS TO MAKE YOUR ANSWER MORE DETAILED:</b></p> <p><b>Buzz words:</b>                  Commodities boom, allocative and technical efficiency</p> <p><b>Economic analysis:</b>                  Higher aggregate demand facilitates higher growth</p> <p><b>Names / quotes:</b>                  Dr. Ken Henry, Glenn Stevens, Ross Gittins, Brookings Institution</p> <p><b>Diagrams:</b>                  Income and Expenditure diagram, Aggregate Demand &amp; Supply diagram</p> <p><b>Complex issues:</b></p> <ul style="list-style-type: none"> <li>➔ Growth is caused by domestic policy, as well as natural and external forces.</li> <li>➔ Macro policy can cause short-term growth, whereas effective micro policy causes long-term growth.</li> </ul>																								
<p><b>MINI PLAN</b></p>	<p><b>MINI PLAN:</b></p> <table border="0"> <tr> <td><b>Introduction</b></td> <td></td> <td>2 paragraphs</td> <td>4 minutes</td> </tr> <tr> <td><b>Part 1</b></td> <td>Macro policy</td> <td>5 paragraphs</td> <td>10 minutes</td> </tr> <tr> <td><b>Part 2</b></td> <td>Aggregate demand and natural</td> <td>5 paragraphs</td> <td>10 minutes</td> </tr> <tr> <td><b>Part 3</b></td> <td>Micro policy</td> <td>4 paragraphs</td> <td>8 minutes</td> </tr> <tr> <td><b>Part 4</b></td> <td>Globalisation</td> <td>3 paragraphs</td> <td>6 minutes</td> </tr> <tr> <td><b>Conclusion</b></td> <td></td> <td>1 paragraph</td> <td>2 minutes</td> </tr> </table>	<b>Introduction</b>		2 paragraphs	4 minutes	<b>Part 1</b>	Macro policy	5 paragraphs	10 minutes	<b>Part 2</b>	Aggregate demand and natural	5 paragraphs	10 minutes	<b>Part 3</b>	Micro policy	4 paragraphs	8 minutes	<b>Part 4</b>	Globalisation	3 paragraphs	6 minutes	<b>Conclusion</b>		1 paragraph	2 minutes
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<b>Part 4</b>	Globalisation	3 paragraphs	6 minutes																						
<b>Conclusion</b>		1 paragraph	2 minutes																						

**INTERNET RESOURCE:**

👉 South Centre - 'Revenue Implications of WTO NAMA Tariff Reductions' - [http://www.uneca.org/eca\\_programmes/trade\\_and\\_regional\\_integration/atpc/documents/nama\\_fiscrevdep\\_dec04.pdf/](http://www.uneca.org/eca_programmes/trade_and_regional_integration/atpc/documents/nama_fiscrevdep_dec04.pdf/). An analysis of the impact of tariff reductions on developing countries. See page 3 for a table illustrating developing countries' dependence on tariff revenues.

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# Definitions:

## Definition of 'Aggregate Demand':

- ☒ Aggregate demand is the total demand for final goods and services in the economy at a specific point in time.
- ☒ The components of aggregate demand are domestic spending by consumers, firms and governments, and the net external sector (exports - imports).

## Definition of 'Appreciation':

- ☒ An appreciation is an increase in the relative value of a currency. It is a rise in the price of one currency in terms of another. That is, a rise in the exchange rate.

## Definition of 'Asia Pacific Economic Cooperation (APEC)':

- ☒ The Asia Pacific Economic Cooperation group is a simple, cooperative bloc formed in 1991 with the intention of creating a freer trade organisation.

## Definition of 'Association of Southeast Asian Nations (ASEAN)':

- ☒ The Association of Southeast Asian Nations developed from a simple cooperative group into an increasingly sophisticated economic bloc, consisting of 10 states from southeast Asia.

## Definition of 'Australia's Current Mix of Non-Market/Market Wage Systems':

- ☒ Australia has a hybrid system for wage determination. It is underpinned by a centralised system for returns to labour. This is the minimum award, which is adjusted/reviewed annually in the Minimum Wage Panel's wage case.

## Definition of 'Awards':

- ☒ Awards outline the minimum wages and working conditions that must be granted to employees in certain industries.
- ☒ Other minimum conditions are outlined by the National Employment Standards.

## Definition of 'Balance of Goods':

- ☒ The balance of goods is the monetary record of the value received (credits) and paid (debits) for physical exports and imports.

## Definition of 'Balance of Payments':

- ☒ The Balance of Payments is a monetary record of transactions into and out of Australia.

## Definition of 'Budget Outcome':

- ☒ The summary of government expenditure and revenue for the next year. It is expressed either as a budget deficit (whereby expenditure is higher than revenue), a budget surplus (whereby revenue is greater than expenditure), or a balanced budget (whereby revenue and expenditure are equal).



This section provides inputs to help you successfully answer multiple choice and short answer questions, and highlights issues you should be wary of - types of questions that often confuse students and the tactics examiners use to trick students.

## International economic integration

- ✎ Make sure you understand the concept of **international convergence**.

Examiners try to catch students out with an incorrect alternative saying that globalisation has caused international **divergence**. These similar-sounding and difficult terms often confuse students in exam conditions.

Remember, globalisation has caused convergence of **economic structures** and **policies**.

- ✎ Be clear on concepts of the **international** business cycle and the **regional** business cycle.

Beware of incorrect alternatives that confuse the two.

- ✎ Questions may ask about **trade or financial flows**. Both have increased because of globalisation.

**Don't confuse the two.** Read the question carefully and make sure you know what it is asking, because it may be about the size, direction, or composition of these flows.

## Free trade and protection

- ✎ A **higher quota is an example of lower protection** (because more foreign goods are allowed into the country). A lower quota is an example of higher protection.

This is different to all the other forms of protection – a **higher tariff** or subsidy is an **increase** in protection.

- ✎ The prevention of **dumping is the only justifiable reason** for protection.
- ✎ A common question asks about a '**non-economic**' reason for protection. **Defence** is the only correct answer from the syllabus.

- ✎ Pay attention to the **direction** of the question - is it about the effects of **higher or lower** protection? Examiners try to confuse students with incorrect alternatives which relate to the opposite.

- ✎ Pay attention to whether the question specifically asks about **costs or benefits**, or simply the **general** effects. Watch out for incorrect options that describe the opposite of what is asked.

Examiners may also list multiple effects in each option, of which only one is incorrect.



# Tips - MULTIPLE CHOICE / SHORT ANSWERS

- 👉 Students are sometimes confused by **short-term** and **long-term** effects. In the short-term, lower protection tends to harm economic outcomes like growth, but has a positive effect in the long-term. Don't fall into the trap of choosing the economically positive option, for example, if the question specifically asks about the short-term.
- 👉 Overall, Australia's strategy has been to lower protection, starting from the 1970s.
- 👉 Don't get confused by incorrect alternatives that state Australia has completely free trade. It retains tariffs and other forms of protection for industries such as the auto industry.

## IOs, trade blocs and agreements, and forums

- 👉 Questions about the **role** of a certain organisation are asking only for what it **aims** to achieve. Make sure you read the question carefully to identify which **particular organisation** is being asked about. Incorrect alternatives often correctly describe other organisations.
- 👉 If the question is asking about the **importance or influence**, it is referring to the role the organisation actually plays, as opposed to its aims. Generally, the **best option** is the one identifying that the importance or influence has declined. This is particularly relevant to the WTO, which has become less important in the face of trade blocs and agreements.
- 👉 Learn precise definitions and information for each organisation. Questions often ask for **features** or **characteristics** of an organisation. Incorrect alternatives frequently list features of **other organisations**, which can confuse students who only have vague knowledge. Watch out especially for questions about the IMF and World Bank as students often get the two mixed up.
- 👉 The **OECD** is comprised of **only** advanced economies. Don't get confused by incorrect alternatives listing emerging economies as members.
- 👉 Examiners might try to confuse students about the G20 and the G7/8. The G7/8 is made up of advanced economies. The **G20 has a broader membership**, including emerging economies like China and Brazil, and according to many has become more important than the G7/8.
- 👉 Remember the main functions of the organisations and forums:

  - 👉 **WTO**: (1) Lower protection worldwide to **boost trade**; and (2) **settle trade disputes** through the Dispute Settlement Body ('World Trade Court').



## Globalisation

Information

What is the definition of globalisation?

Countries are 'moving closer' by breaking down

1. Man-Made Barriers
2. Natural Barriers

Man-made barriers to what are being broken down?

1. Labour
2. Investment and transnationals
3. Finance
4. Trade
5. Technology – transport and communications

What has happened to the international business cycle?

1. Increased synchronisation worldwide

Who are the main participants in the Foreign Exchange Market?

1. Firms: exporting and importing
2. Firms: borrowing and lending money overseas
3. Individuals indirectly through buying imports
4. Government - Reserve Bank dirtying the float

What are the impacts of changes in trade and financial flows on an economy?

1. Structural change
2. Exchange rate change

From an economics perspective the world is broken down into three groups:

1. Emerging economies
2. Advanced economies
3. Developing economies – high growth and low growth

## Globalisation -

Effects/Cause

What are the advantages of free trade (the reasons for globalisation)?

1. Improve growth
2. Modern technology
3. International competition
4. Comparative advantage
5. Economies of scale
6. Greater variety of products
7. Political benefits



## Globalisation -

## Effects/Cause

Identify the areas upon which globalisation impacts:

1. Quality of life
2. Unemployment
3. Environment
4. Economic growth
5. External stability
6. Income and wealth distribution
7. International business cycle
8. Inflation
9. Trade
10. Transnational corporations
11. Investment

## Globalisation -

## Policies

What strategies are being used by governments to promote growth?

1. Improve the factors of production - capital, labour, entrepreneurial skills, natural resources
2. Bring in policies of a competitive nature and to enhance trade

What is the most important factor that can achieve stronger growth?

1. Obtaining capital - internally or externally

**Protection****Cause**

What are the reasons for protection?

1. Defence (importance of sectors)
2. Employment (protect domestic)
3. Quarantine against diseases
4. Infant industry (develop domestic)
5. Protection against dumping

What is the only justifiable reason for protection?

1. Dumping

What is the only non-economic reason for protection?

1. Defence

**Protection -****Policies**

What are the methods of Protection?

1. Local content rule
2. Voluntary export restraints
3. Quotas
4. Export incentives
5. Tariffs
6. Subsidies

**Protection -****Effects**

What areas are considered when looking at the implications of lowering protection?

1. Firms - expanding and contracting
2. Individuals - wages, household expenditure, distribution of income, taxation, strikes
3. Governments - policies and objectives

What are the implications of protectionist policies of other countries and international organisations on Australia?

1. Structural change
2. Lower growth
3. Worsening CAD



## International organisations, trade blocs and agreements, forums

### Information

What are the main international organisations?

1. International Monetary Fund (IMF)
2. World Bank
3. World Trade Organisation (WTO)
4. United Nations (UN)
5. Organisation for Economic Cooperation and Development (OECD)

What are the main forms of trade integration?

1. Bilateral free trade agreements
2. (Multilateral) trade blocs
3. Monetary unions

What were the outcomes of the Uruguay Round?

1. Services reforms
2. Reforms in agriculture, such as lowering protection
3. Protection of intellectual property
4. A new multi-fibre (clothing) agreement
5. Creation of the Dispute Settlement Body (the 'world trade court')

What are the possible outcomes of the Doha Round?

1. New fibre agreement
2. Labour laws
3. Environmental clauses
4. Agriculture agreement
5. Greater patent protection for drugs

What are the major trade blocs and Economic forums?

1. NAFTA
2. APEC
3. ASEAN
4. EU
5. G7/G8
6. G20

What is the debate concerning the creation of trade blocs?

1. Trade creation vs. trade diversion

What is the name of Australia's free trade association with New Zealand?

1. CERTA



## CALCULATIONS - MULTIPLE CHOICE / SHORT ANSWERS



## Keynesian calculations: MPC - multiplier - change in income:

## A: The Marginal Propensity to Consume (MPC)

**Formula time: The Marginal Propensity to Consume (MPC)**

The triangular symbol  $\Delta$  is the mathematical symbol for change.

Change in Consumption ( $\Delta C$ ) / Change in Income ( $\Delta Y$ )

**Example time:**

Using the information provided in the table below, calculate the MPC.

Year	Income	Consumption
1	100	40
2	200	100

$$MPC = \frac{\Delta C}{\Delta Y}$$

$$MPC = \frac{60}{100}$$

✂ For exams, it is usually safer to keep the MPC in a fraction form. ✂

$$MPC = \frac{3}{10}$$

## B: The Multiplier (k)

**Formula time: The simple multiplier**

The simple multiplier is represented by the symbol 'k' and is calculated using the formula:

$$k = \frac{1}{MPS} \quad \text{or} \quad k = \frac{1}{1 - MPC}$$

Note: MPS can be substituted for  $1 - MPC$

✂ For exams, it is usually safer to use the formula  $k = 1 / MPS$  ✂

**Calculation time:**

If the MPC is 0.6, what is the multiplier?

**Step 1: Find the MPC**

(In this question the MPC is given.)

In most questions you will need to calculate the MPC)

$$MPC = 0.6 \quad (\text{✂ Hint: always change the decimal into a fraction} = 3/5)$$

**Step 2: Find k (the multiplier)**

$$k = \frac{1}{1 - MPC}$$

$$k = \frac{1}{1 - 3/5}$$

$$k = \frac{5}{2}$$

$$k = 2.5$$



# CALCULATIONS - MULTIPLE CHOICE / SHORT ANSWERS

## C: Change in income

Formula time: **Change in income**

$$\Delta Y = \Delta I \times k$$

Change in income = Change in investment/aggregate demand x simple multiplier

If the MPC is 0.6 and there is an initial injection of \$100,000 from investment, how much would national income rise?

**Step 1: Find the MPC** (In this question the MPC is given.  
In most questions you will need to calculate the MPC)  
MPC = 0.6 (✂ **Hint: always change the decimal into a fraction = 3/5**)

**Step 2: Find k (the multiplier)**  

$$k = \frac{1}{1 - MPC}$$

$$k = \frac{1}{1 - 3/5} \qquad k = 5/2 \qquad k = 2.5$$

**Step 3: Find the change in income**  

$$\Delta Y = \Delta I \times k$$

$$\Delta Y = \$100,000 \times 2.5 \qquad \Delta Y = \$250,000$$

Ultimately, national income would increase by \$250,000.



## Keynesian calculations: Aggregate demand - equilibrium income:

Formula time: **Aggregate demand**

The equation to calculate aggregate demand (equilibrium income) is:

$$AD = C + I + G + (X - M)$$

- C = Consumer spending refers to expenditure by private households
- I = Business investment refers to firms buying capital goods and an increase in inventories (unsold goods)
- G = Government spending
- X - M = Net exports subtracts import spending (M) from export revenues (X)

**Example time:**

Using the information provided in the table below, calculate equilibrium income.

Consumption	Investment	Government spending	Exports	Imports
10	4	2	4	5

$$AD = C + I + G + (X - M)$$

$$= 10 + 4 + 2 + (4 - 5)$$

$$= 15$$



# INTRODUCTIONS FOR EXTENDED RESPONSE QUESTIONS

## Globalisation:

Globalisation is the reduction of natural and man-made barriers to labour, investment, finance, and trade. By lowering protection, it creates growth in individual economies, which has significant flow-on effects. However, the benefits are neither uniform nor absolute. Within all economies, it has caused increased inequality and environmental problems, while certain countries, especially developing countries, have suffered. Governments must take action to reap the benefits of globalisation. This includes micro reforms to increase international competitiveness domestically, and steps to boost access to trade globally, such as unilateral cuts in protection and joining bilateral or multilateral trading agreements. All countries have an obligation to help make globalisation fairer and the world economy more stable.

## Free trade and protection:

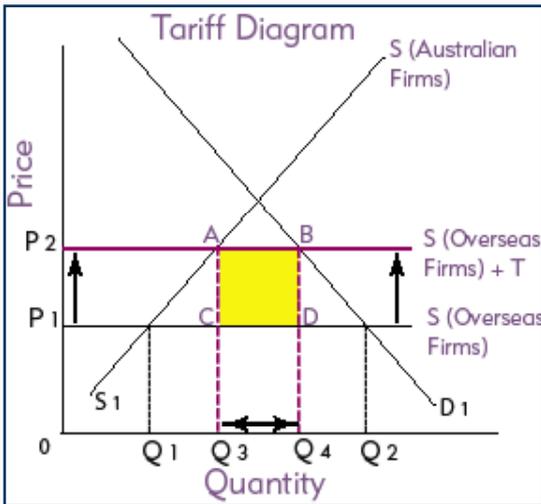
With the onset of globalisation, Australia has tended towards free trade, with a marked decrease in protection. Successive governments have cut tariff levels, as well as reduced other forms of protection like subsidies and restrictive quotas, whether unilaterally or as part of multi- or bilateral agreements. For consumers, this has been very positive. Increased competition has led to a wider variety of cheaper, better quality goods. Firms that have been able to adapt and compete have benefited greatly, but others have been unable to, causing the decline of certain domestic industries and short-term unemployment, although this will change in the long-term. Similarly, it may therefore cause short-term external stability and economic growth problems, although they too will be reversed. Moreover, lower protection means that Australia forgoes its undeniable benefits, such as self-sufficiency and boosting widespread domestic industry growth, although from a global perspective, lowering protection remains the correct action.

## External stability/CAD:

Keating famously once said that Australia risks becoming a “banana republic” because of its persistently high CAD. This view should be challenged. Indeed, the dominant opinion now is that a high CAD is not problematic in Australia’s unique case, embodied by the Pitchford Theory. The capital inflow is, in fact, seen as a benefit to the economy. On the other hand, though, there are significant potential detriments, such as a debt trap situation and a loss of investor confidence. The government should then address the causes of the high CAD, particularly problems with goods and services, and a persistent Primary Incomes account deficit. Micro reforms can improve domestic exporters’ international competitiveness, while the Primary Incomes problem can be reduced by a budget surplus, as per the Twin Deficits theory, as well as schemes like superannuation to boost domestic savings.

Tariff diagram - imposition of a tariff

Turning these diagrams into paragraphs for your essays:



The diagram illustrates the effect of an increase in the level of tariffs. An increase in tariffs forces the price of imports up from  $P_1$  to  $P_2$ , leading to a decrease in supply of the good from overseas, as shown by the upwards shift of the curve  $S(os)$  to  $S(os)+T$ . This is caused by the effective increase in the cost of overseas production caused by the tariff.

Before the tariff, at price  $P_1$ , local firms were prepared to supply  $Q_1$ . Imports were  $Q_1Q_2$ . After the price increase to  $P_2$ , local firms are willing to supply  $Q_3$ . Imports supply  $Q_3Q_4$ . This means there is greater demand for domestic production, up from  $Q_1$  to  $Q_3$ .

Additionally, as a tariff is a tax imposed on imported goods, it raises revenue for the government. The size of the tariff is  $P_1P_2$  (assuming it is passed wholly on to the consumer), so the increased revenue is represented by the area  $ABCD$ .

Tips for using this diagram:

You should discuss the negative effects of a tariff, such as supporting inefficient domestic firms due to reduced competition, and the possibility for international retaliation, as well as reasons for imposing it, such as protecting an infant domestic industry.

This diagram can be used in questions such as:

- What are the effects of increased protection?
- Discuss different methods of protection.
- Discuss the causes of higher inflation.

Tariff diagram - reduction of a tariff

Turning these diagrams into paragraphs for your essays:

The diagram illustrates the effects of a reduction in tariff levels. The size of the reduction of the tariff is  $P_1P_2$ , so the price of the imported good falls from  $P_1$  to  $P_2$ . Removal of the tariff effectively decreases overseas production costs so overseas supply increases, shown by the downward shift of the curve  $S(os)+T$  to  $S(os)-T$ .

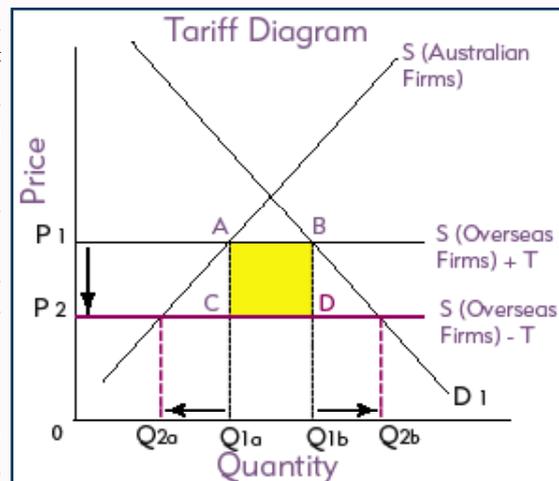
At  $P_1$  domestic firms supplied  $Q_{1a}$  and imports supplied  $Q_{1a}Q_{1b}$ . At the cheaper price  $P_2$ , domestic firms are only willing to supply  $Q_{2a}$ , while importers supply  $Q_{2a}Q_{2b}$ . Also, government revenue from the tariff is reduced by  $ABCD$ .

Tips for using this diagram:

You should also discuss reasons for reducing tariffs, such as encouraging greater efficiency in domestic industries by exposing them to competition, and promoting free trade around the world. Consumers pay a lower price ( $P_2$ ) and total consumption rises (from  $Q_{1b}$  to  $Q_{2b}$ ).

This diagram can be used in questions such as:

What are the effects of changes in protection levels?



Note:  $S(os)+T$  = the supply from overseas firms with the tariff  
 $S(os)-T$  = the supply from overseas firms with the tariff reduced

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