

Trial Examination 2021

VCE Economics Units 3&4

Written Examination

Suggested Solutions

SECTION A – MULTIPLE-CHOICE QUESTIONS

1	☐ A	☐ B	☐ C	☒ D
2	☐ A	☐ B	☒ C	☐ D
3	☐ A	☐ B	☐ C	☒ D
4	☐ A	☐ B	☐ C	☒ D
5	☒ A	☐ B	☐ C	☐ D
6	☐ A	☐ B	☒ C	☐ D
7	☐ A	☒ B	☐ C	☐ D
8	☐ A	☐ B	☐ C	☒ D
9	☒ A	☐ B	☐ C	☐ D
10	☐ A	☐ B	☒ C	☐ D
11	☐ A	☒ B	☐ C	☐ D
12	☐ A	☐ B	☒ C	☐ D
13	☐ A	☒ B	☐ C	☐ D
14	☐ A	☐ B	☐ C	☒ D
15	☒ A	☐ B	☐ C	☐ D

Question 1 D

D is correct. The economic problem of relative scarcity exists because resources are finite, as they have physical limits, but needs and wants are infinite, as they can never be fully satisfied. **A** and **C** are incorrect. Resources are not infinite. **B** is incorrect. Resources are finite in an economy, but the needs and wants of society are not finite.

Question 2 C

C is correct. The value of Gross Domestic Product (GDP) is negative in Quarter 4, which indicates a slowing economy. The unemployment rate is above the Non-Accelerating Inflation Rate of Unemployment (NAIRU) of 4.5–5.0% and the Consumer Price Index (CPI) is below the accepted range of 2–3%. All these elements indicate a contracting economy. **A** and **B** are incorrect. A peak or expansion would show GDP to be steadily rising over the year. The data shows a rising and falling rate of GDP over the year. **D** is incorrect. A trough would have occurred if the data showed two consecutive quarters of negative growth. The data shows two quarters of negative growth, but they are not consecutive.

Question 3 D

D is correct. An accurate definition of technical, or dynamic, efficiency is when resources are allocated in the most profitable way possible. **A** is incorrect. Allocative efficiency, not technical efficiency, refers to the most efficient allocation of resources. **B** is incorrect. This option mentions the current allocation of resources and does not refer to this allocation being efficient when maximising the needs and wants of society. **C** is incorrect. Intertemporal efficiency, not technical efficiency, refers to the future allocation of resources.

Question 4 D

D is correct. Economic agents (buyers and sellers) do not have the power to affect the price in a perfectly competitive market. **A** is incorrect. Homogenous products are a characteristic of a perfectly competitive market, as the products sold in the market are virtually identical and substitutable. **B** is incorrect. There are large numbers of buyers and sellers in the market, which limits market dominance and allows for greater competition between the participants in the market. This is characteristic of a perfectly competitive market. **C** is incorrect. A perfectly competitive market is one that features low set-up costs for new market entrants, meaning there is ease of entry and exit into the market.

Question 5 A

A is correct. Population growth causes an increase in demand, as demonstrated in the diagram. **B** is incorrect. This diagram shows a decrease in demand as a result of the increase in population. **C** and **D** are incorrect. These diagrams show a shift in the supply curves and population growth is a demand factor.

Question 6 C

C is correct. The relationship between the price of a product and the quantity of the product demanded in the market is inverse. This option correctly identifies that lower prices increase the quantity demanded. **A** and **D** are incorrect. These options state that the relationship between the price and quantity demanded is positive, which it is not. **B** is incorrect. When demand decreases, the whole demand curve shifts to the left, which is caused by non-price factors decreasing the quantity in the market.

Question 7 B

B is correct. Buying Commonwealth Government Securities will increase cash in the overnight money market and decrease pressure on interest rates, causing them to fall and leading to an expansionary monetary policy stance. **A** is incorrect. Buying Commonwealth Government Securities is not a neutral stance because this will increase cash in the overnight money market. **C** is incorrect. Selling Commonwealth Government Securities will decrease cash and put pressure on interest rates to rise. This is a contractionary monetary policy stance. **D** is incorrect. Buying Commonwealth Government Securities leads to an expansionary monetary policy stance and the outcome of this is known.

Question 8 D

D is correct. The scenario is a non-price supply factor (climatic conditions), which causes a decrease in aggregate supply. When the price increases and quantity decreases, this indicates a decrease in aggregate supply. **A** is incorrect. When the price and quantity decrease, this indicates a decrease in aggregate demand. **B** is incorrect. When the price and quantity increase, this indicates an increase in aggregate demand. **C** is incorrect. When the price decreases and the quantity increases, this indicates an increase in aggregate supply.

Question 9 A

A is correct. A market with high price elasticity has demand and supply lines that are more horizontal and the surplus (the difference between what is demanded and what is supplied in the market) has a greater difference. **B**, **C** and **D** are incorrect. In these markets, the demand and supply lines are more vertical and the surplus has a smaller difference.

Question 10 C

C is correct. The availability of money and credit transmission mechanism refers to the number of loan approvals provided by financial institutions. **A** is incorrect. The cost of credit transmission mechanism refers to the impact of a change in the interest rate on the finances of Australian households and their willingness to borrow money. **B** is incorrect. The cash flow transmission mechanism refers to the impact of a change in the interest rate on the finances (discretionary incomes) of Australian households. **D** is incorrect. The asset prices and wealth transmission mechanism refers to the value of assets in the economy.

Question 11 B

B is correct. The annualised growth rate is calculated by taking a quarterly GDP figure and multiplying it by four to arrive at an annualised growth rate figure. **A** is incorrect. The annualised growth rate is not calculated by taking the annual growth figure and converting it for the current year. **C** is incorrect. The annualised growth rate is not calculated by taking an annual growth figure and converting it to a quarterly amount. **D** is incorrect. The annual growth rate of the previous year would already be calculated.

Question 12 C

C is correct. A deficit budget outcome refers to when government expenditure is greater than government income. This is considered an expansionary budget outcome. **A** is incorrect. A balanced budget outcome refers to when government expenditure is equal to government income. This is considered a neutral budget outcome. **B** is incorrect. A surplus budget outcome refers to when government income is greater than government expenditure. This is considered a contractionary budget outcome. **D** is incorrect. There is no such thing as a positive budget outcome.

Question 13 B

B is correct. There are always various options when it comes to government spending and there are always alternative ways that government money can be spent in the economy. **A** is incorrect. Budgetary policy initiatives can target more than one government goal simultaneously. **C** is incorrect. Some budgetary policy measures benefit the individual more than society. For example, a tax cut may be used to pay off a debt that benefits the individual and not society. **D** is incorrect. The budget must pass through both houses of parliament but does not need to be approved by the major political parties to be passed as legislation, as the government can get the support of minor political parties to pass the budget.

Question 14 D

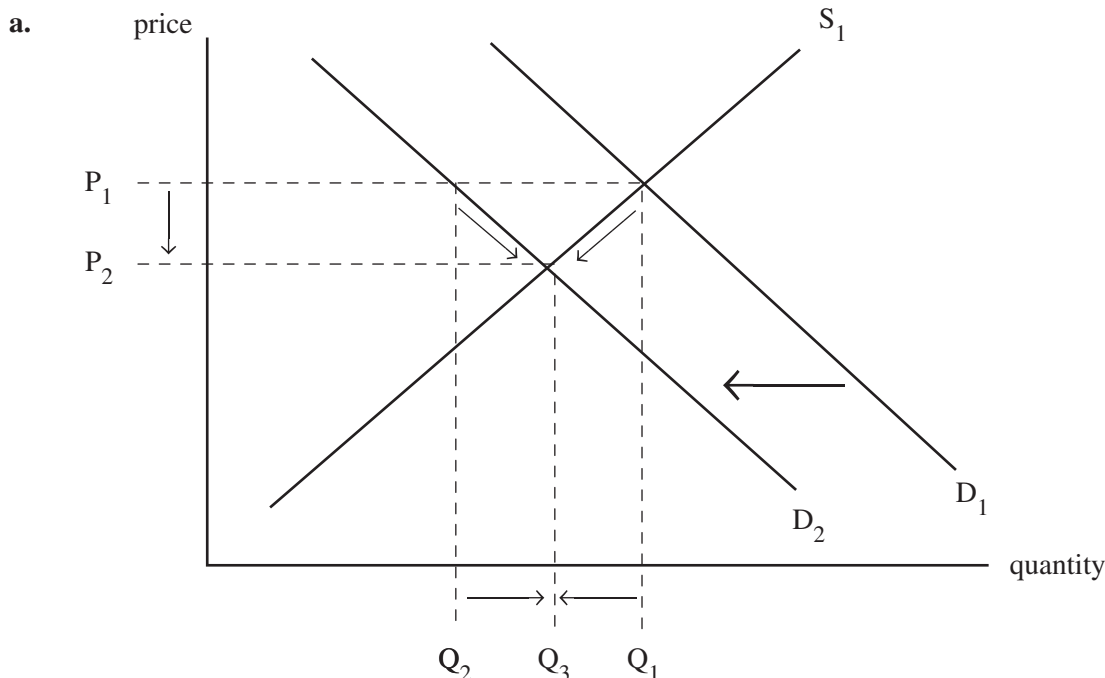
D is correct. A credit records money coming into Australia from overseas and net services records all services (like tourism) in the current account. **A** and **B** are incorrect. Debits in the current account record money leaving Australia and being sent to another country. **C** is incorrect. The balance of merchandise trade records goods only and tourism is a service.

Question 15 A

A is correct. An increase to Australia's population through immigration will increase the labour force in Australia. **B** is incorrect. Work visas are granted to skilled workers in areas where Australia has a skill shortage. **C** is incorrect. Immigrants can bring with them world's best practice, which enhances productivity in Australia. **D** is incorrect. Immigrant workers can enhance relationships with trading partners, which can help to facilitate export growth in Australia.

SECTION B

Question 1 (18 marks)



The business cycle shows the fluctuations in GDP or economic activity that an economy experiences over a period of time. A contraction in the business cycle shows a downturn in economic activity with lower levels of consumption, investment and net exports. Aggregate demand shows the total expenditure on new final goods and services. As a result, a contraction in the business cycle causes aggregate demand to decrease (the aggregate demand curve shifts to the left from D_1 to D_2) as shown in the diagram above.

The decrease in aggregate demand causes a surplus of goods and services in the economy at P_1 . To eliminate the surplus, there is a contraction in supply and expansion in demand, which decreases the price (P_1 to P_2) and quantity (Q_1 to Q_3) until a new equilibrium price and quantity is reached by the market.

4 marks

1 mark for accurately drawing the demand and supply lines showing a decrease in demand (shift to the left as shown by the labelling of demand lines).

1 mark for showing the impact of this change in aggregate demand on price, quantity and supply (as shown by the use of arrows).

1 mark for explaining a contraction in the business cycle and the impact on aggregate demand.

1 mark for explaining how a decrease in aggregate demand impacts supply, price and quantity.

- b. The labour market refers to the demand for and supply of labour or jobs in an economy. Employees provide the supply of labour to the market while employers provide the demand for labour in the market. When an economy is in the contractionary stage of the business cycle, the demand for labour from employers decreases. Therefore, the relationship between the contractionary phase of the business cycle and the labour market is opposite. This means that as economic activity and the demand for labour decrease, there will be an excess of the supply of labour in the labour market. This is because when consumption decreases, there is lower demand for labour in the economy due to lower demand for the production of goods and services in the economy.

3 marks

1 mark for explaining how demand and supply operate in the labour market.

1 mark for identifying the relationship between the contractionary phase of the business cycle and the labour market.

1 mark for explaining this relationship.

- c. *For example:*

Price elasticity refers to how reactive the market is for a good or service when there is a change in price. The price elasticity of demand is the degree of responsiveness in quantity demanded to changes in price. When the percentage change in quantity demanded is greater than the percentage change in price, a good or service is said to be elastic, meaning that any decrease in price will lead to a larger percentage increase in demand.

A number of factors will determine whether a good or service is price elastic or not. They include the degree of necessity of the good or service (whether it is a need or a want), the availability of substitutes for the good or service, the proportion of income consumers spend on the good or service and the time taken to buy the good or service.

Diamonds are a luxury status item in society. As they are not considered a necessity for life, they have a high price elasticity. This means that any increase in the price of diamonds will see a much larger percentage decrease in the purchase of diamonds by consumers. Likewise, when jewellers have sales and lower the price of diamonds, there is a much bigger percentage increase in consumption of diamonds by consumers.

3 marks

1 mark for explaining price elasticity.

1 mark for providing an example of a product that is price elastic.

1 mark for explaining why that product is price elastic.

Note: Other examples of price elasticity may include services like luxury holidays; widely available substitute products like fruits and vegetables; and expensive items like new cars.

- d. Relative prices are the prices of goods or services in terms of other goods or services, expressed as a ratio of the prices. Relative prices send signals to consumers that they should alter their consumption behaviour to gain greater satisfaction, and to suppliers that they should redirect their resources to more profitable markets to make larger profits.

Electricity can be produced in a number of ways using both renewable (solar power) and non-renewable (coal-powered electricity stations) resources. Solar electricity is becoming a more popular source of electricity in Australia as consumers are given credits if they do not use all of the electricity that is generated by the solar panels on their properties. Likewise, electricity providers can use the excess electricity provided by households to decrease their costs of production. The higher demand for solar-powered electricity causes the relative price of solar panels to rise in comparison to coal-powered electricity, and more resources are directed towards the solar-powered electricity market and away from the coal-powered electricity market.

As a result of this, there is an increase in demand for solar power by consumers and there is also an increase in supply of electricity due to the excess electricity generated by solar panels. As consumers get credits when they do not use all the electricity they generate, this will increase their discretionary income. In turn, this will enable them to buy more goods and services that they would otherwise not have had the funds to purchase, increasing satisfaction levels. This has a positive impact on both material and non-material living standards in Australia.

4 marks

1 mark for explaining relative prices.

2 marks for explaining the impact of relative prices for solar power on the market.

1 mark for explaining the impacts of this on Australian living standards.

- e. *For example:*

Asymmetric information is a situation in which one party in a transaction has more information than the other party in the transaction. As a result, the wellbeing of the individual with less information is not maximised, leading to an inefficient allocation of resources for the individual and society.

An example of asymmetric information taking place in the economy is the used car market. In this market, the seller has greater knowledge of the car's potential defects than the buyer. If the buyer purchases the used car, they may be unaware of the defects that come with the car. As a result of this lack of information, the buyer may need to spend extra funds on car repairs in the future.

The government addresses the market failure of asymmetric information through consumer laws that protect customers from misleading or deceitful behaviour from sellers. Information about used cars must be available and truthful, and this ensures that both sellers and buyers have access to the same information. Used cars are also covered by mandatory warranties when a consumer purchases a car from a dealer, which cover the cost of repairs for a time period. This also prevents the inefficient allocation of resources as the car buyer does not have to pay for the cost of repairs during the warranty period.

4 marks

1 mark for defining asymmetric information.

1 mark for providing an example of asymmetric information in the Australian economy.

1 mark for explaining how the Australian Government addresses asymmetric information.

1 mark for explaining how this addresses the market failure.

Note: Other examples could include consumer rights from the Australian Competition and Consumer Commission (ACCC); a guide to buying a used car from Consumer Affairs; federal government advertising promoting the benefits of the COVID-19 immunisation program; and government subsidies, like the government covering the cost of vaccinations for COVID-19.

Question 2 (16 marks)**a.** *For example:*

Strong and sustainable economic growth is a situation in which the Australian economy has continuous or sustained economic growth and avoids any negative or weak growth over a given time period. This is generally considered to be within the range of 3 to 3.5% of growth per year. Any growth above that is seen as excessive and can lead to inflationary pressures in the economy. Any growth below 3% is seen as being too low and can lead to higher rates of unemployment. Strong and sustainable economic growth can be achieved through cyclical and structural budgetary policy measures.

Cyclical budgetary policy measures (also referred to as automatic stabilisers) are built into the Australian Government's Budget and occur as a result of changes in the level of economic activity. There is no deliberate government intervention regarding the operation of cyclical budgetary policy measures.

Automatic stabilisers work in a counter-cyclical manner and, when the economy is in the contractionary or trough stage of the business cycle, automatic stabilisers inject more money into the economy. During the contractionary phase of the business cycle, government revenues decrease (as less people work and pay tax) and government welfare payments increase (as more people become unemployed and receive government assistance), leading to a deficit or expansionary budget to attempt to maintain spending levels and economic activity.

During 2020, as more people became unemployed as a result of the COVID-19 pandemic, the budget became expansionary in nature as government revenue (leakages) fell and government expenditure (injections) rose in order to maintain and increase economic activity. This is a cyclical measure aimed at counteracting the trough stage of the business cycle.

Structural budgetary policy measures (also referred to as discretionary stabilisers) are the deliberate policy decisions made by the government that alter the composition of government revenues and expenses to influence the level of economic activity.

When the Australian economy was heading towards a recession in 2020, the Federal Government announced stimulus packages in March aimed to support the Australian economy. Measures included two stimulus payments of \$750 for pensioners, a reduction of individual income tax rates and a reduction of the instant asset write-off scheme for businesses. Further stimulus packages were announced in the 2021 Budget with a further \$7.8 billion in tax cuts for low- and middle-income earners, worth up to \$1080 for individuals and \$2160 for couples. These structural measures were aimed at providing households with more discretionary income to spend on the consumption of goods and services, and providing businesses with greater profit levels that could be used to re-invest in the economy, thus maintaining and increasing economic activity.

8 marks

2 marks for explaining how cyclical budgetary policy measures operate within the Budget.

2 marks for providing an example that shows the effect cyclical components have on economic growth.

2 marks for explaining how structural budgetary policy measures operate within the Budget.

2 marks for providing an example that shows the effect structural components have on economic growth.

Note: Other examples could include JobSeeker, the JobKeeper payment and the early release of superannuation to individuals.

- b. The role of monetary policy is to achieve stability of the currency, meaning price stability in which the CPI is kept on average between 2–3%. Once price stability has been met, the Reserve Bank of Australia (RBA) looks at maintaining full employment and economic growth. From 2020 to 2021, the monetary policy stance has been extremely expansionary, with the cash rate dropping from 1.5% at the start of 2019 to the current rate being 0.1%. The cash rate has been decreased to enhance consumption and investment spending by households and firms.

As the CPI has been sitting below the target rate over the past two years, the achievement of price stability has not been a priority for monetary policy and the RBA has turned its attention to focusing on achieving full employment and economic growth. The expansionary stance of monetary policy has helped to bring full employment close to the target of 5% NAIRU as low interest rates have given incentives for households (through increased discretionary income) and firms (through increased profits) to continue to consume and invest in the Australian economy. Nevertheless, over the past two years economic activity in Australia has been sitting well below the target range of 3 to 3.5%, with GDP being approximately 1% over the last two years.

The COVID-19 pandemic has further hindered the effectiveness of the achievement of the goal of economic growth, with the Australian economy experiencing a recession during the second and third quarter of 2020 due to forced government lockdowns. During this time, the RBA also introduced quantitative easing where it bought back government bonds to increase the money supply to stimulate the economy. These measures have worked to deliver positive economic growth in the last quarter of 2020, ensuring the recession was short-lived. However, it is evident that monetary policy alone cannot guarantee the achievement of the government's goal of strong and sustainable economic growth, as stimulus from budgetary policy initiatives are also required and necessary.

4 marks

*2 marks for explaining the monetary policy stance from 2020 to 2021.
2 marks for evaluating whether the stance of monetary policy has helped
achieve economic growth in 2020 and 2021.*

c. *For example:*

One strength of budgetary policy is that it can target particular sectors of the economy. This means that any stimulus measures can have a direct impact on the sectors of the economy that require assistance. During the COVID-19 pandemic of 2020, the Federal Government directly provided stimulus packages to households in the form of tax relief for individuals and two payments of \$750 for people on a pension. This was aimed at directly increasing the discretionary incomes of Australian households to promote consumption spending, which directly increases GDP and helps achieve the goal of strong and sustainable economic growth.

One weakness associated with budgetary policy is that providing increased discretionary income to Australian households may not be spent on Australian-made goods and services. The effect of fiscal stimulus is muted when the money put into the economy through tax savings or government spending is spent on imports, sending that money abroad instead of keeping it in the local economy.

4 marks

*1 mark for describing one strength of budgetary policy.**1 mark for explaining how this helps achieve strong and sustainable economic growth.**1 mark for describing one weakness of budgetary policy.**1 mark for explaining how this does not help achieve strong and sustainable economic growth.*

Note: Other acceptable strengths include: a greater range of economic goals can be targeted, short impact lags to influence economic activity, effective in stimulating aggregate demand, and government policies are open to public scrutiny.

Other acceptable weaknesses include: political hurdles and biases associated with policy decisions, time taken to pass as legislation through parliament can be lengthy, and cooperation with state governments is critical to ensure policies are implemented as intended across the country.

Question 3 (16 marks)**a.** The trend shown in the graph indicates a slight increase in the terms of trade.

In January 2019, the terms of trade was approximately 94 index points. In January 2021, the graph shows the terms of trade at approximately 114 index points. This shows an increase in the terms of trade of 18 index points over that time period.

Demand for iron ore from China increased by 11.5% during this period. Due to the increased demand for Australian iron ore from China, the price of this commodity increased. This then caused overall export prices to increase and as a result increased the terms of trade index, as indicated in the graph.

4 marks

*1 mark for describing the trend shown in the graph.**1 mark for using the data in the graph to provide evidence of the trend.**1 mark for outlining one factor that has caused the trend.**1 mark for explaining how this factor causes the terms of trade to change.*

b. *For example:*

The terms of trade is a ratio of the average prices received for Australian exports, relative to the average prices paid for Australian imports. The terms of trade is measured using an index of export and import prices over a period of time. The terms of trade can be interpreted as the amount of import goods an economy can purchase per unit of export goods. When the terms of trade increases, that means Australia is receiving a higher price for commodities such as iron ore and coal on the world market. Likewise, if the prices Australia pays for imports were to fall, that would also lead to an increase in the terms of trade.

The exchange rate is the value of the Australian dollar when compared to another currency. When the demand for Australian exports increases, the Australian dollar will likely appreciate in value and this will increase the exchange rate. That is to say, Australia can get more foreign currency for every Australian dollar on the world market. The reason the Australian dollar appreciates when the terms of trade increases is that, as more money is received for Australian exports due to the increased demand for Australian commodities, higher levels of foreign income need to be exchanged for Australian dollars. The increased demand raises the value of the Australian dollar.

Either of these scenarios (higher prices received for exports or lower prices paid for imports) will have a positive impact on the net export component of the Australian economy. If Australia is receiving a higher price for its commodities in world markets, exporters of commodities will receive more income and make higher profits. As a result of this, it is likely that exporters will increase their investment to further expand their production, and as more labour is demanded, this will result in greater incomes to employees in the export industry.

Living standards refer to both the amount and quality of material goods and services available to a given population, and non-material factors, which are those that make up the quality of life. Workers who are employed in industries that support Australian commodities will experience a higher standard of living. Receiving a higher income has a flow-on effect to increased consumption spending, which results in increased material living standards as more goods and services can be purchased with greater incomes. Also, being able to purchase more goods and services that make life more enjoyable increases a person's quality of life and thus non-material living standards as well.

6 marks

1 mark for explaining the terms of trade.

2 marks for explaining how the trend in the terms of trade impacts the exchange rate.

2 marks for explaining how the trend in the terms of trade impacts net exports.

1 mark for explaining how the trend in the terms of trade impacts living standards.

*Note: Consequential on the trend identified in **Question 3a**.*

c. The goal of full employment:

Full employment is a situation in which the goal of strong and sustainable economic growth is within the target range (3–3.5%) and there is no cyclical unemployment. This can be referred to as the NAIRU and is approximately 5%. This means that when the unemployment rate is 5% or lower, the goal of full employment has been met.

The relationship between the terms of trade and the unemployment rate is inverse. As the terms of trade increases and exporters receive higher prices, it is more likely that they will expand production of exports and investment spending. This will lead to an increase in the derived demand for labour and decrease the unemployment rate.

Australia's balance of payments on current account:

The current account represents a country's imports and exports of goods and services, payments made to foreign investors, and transfers such as foreign aid.

When the terms of trade increases and net export demand increases as a result, then the balance on goods and services will reduce the current account deficit. This is because credits (money coming into Australia for selling exports) will be greater than the debits (money leaving Australia to buy imports).

6 marks

*1 mark for defining full employment.**2 marks for explaining the relationship between the terms of trade and full employment.**1 mark for defining the current account.**2 marks for explaining the relationship between the terms of trade and the current account.***Question 4 (15 marks)**

- a.** Allocative efficiency refers to when the economy's resources are being used in the most efficient way to maximise the needs and wants of society. Aggregate supply helps the economy achieve allocative efficiency because supply-side initiatives that boost efficiency and decrease the costs of production help to subdue inflationary pressures in the economy. E-commerce meal kit companies such as Hello Fresh are seeing a surge in sales due to their convenience, saving consumers both time and money when it comes to family meal preparation. This enables a greater number of consumers to satisfy a greater number of their needs and wants, helping the economy achieve allocative efficiency.

Intertemporal efficiency refers to how well the economy's resources are allocated over different time periods. The Future Fund was established by the Federal Government in 2006 with the purpose of investing for the benefit of future generations of Australians. Areas of investment include the Future Drought Fund (\$4.3 billion dollars) and the Medical Research Future Fund (\$21.1 billion dollars), where the money invested today will be used to tackle future droughts and medical problems faced by Australians. This will ensure that there are better agricultural conditions and a healthier workforce to maintain and grow levels of aggregate supply in the future.

4 marks

*1 mark for defining allocative efficiency.**1 mark for explaining how aggregate supply helps achieve allocative efficiency.**1 mark for defining intertemporal efficiency.**1 mark explaining how aggregate supply helps achieve intertemporal efficiency.*

- b.** Taxation reform is designed to improve the efficiency of taxes and improve economic conditions. Taxation reform can take many forms such as tax concessions, alterations to the amount of direct taxes paid by individuals and firms, and decreasing tax compliance for firms. When the Federal Government initiates taxation reform through decreased company tax or increased tax concessions to firms, it is directly decreasing a firm's costs of production and providing an incentive for a firm to produce more goods and services in the economy due to an increased profit motive.

An example of a taxation reform policy is the reduction in the company tax rate by the Federal Government. In 2019, the company taxation rate was 27.5%. In 2021, the company taxation rate is 25%. This will increase the profits that firms will make and acts as an incentive to further increase production, thereby increasing aggregate supply.

As aggregate supply increases and more goods and services are produced, there is an increase in real GDP and therefore an increase in economic growth. As economic growth increases, there is an increase in the derived demand for labour resources to ensure that the economy can maintain this increased level of production. Therefore, more people have jobs and the goal of full employment is more likely to be met.

5 marks

1 mark for explaining tax reform.

1 mark for explaining how tax reform policies influence aggregate supply.

1 mark for providing an example of tax reform policies influencing aggregate supply.

2 marks for explaining how a change in aggregate supply impacts full employment.

Note: Other acceptable taxation reform policies may include JobMaker, which provides employers with a wage subsidy for each new job created for eligible employees.

- c.** Aggregate supply policies are government initiatives that aim to reduce the costs of production for business while simultaneously making it easier to provide goods and services to the marketplace.

The point at which production of goods and services is at the maximum possible level in an economy is referred to as its productive capacity. When an economy is at its productive capacity it cannot increase the production of goods and services without having more economic resources (land, labour or capital).

The Federal Government announced a \$320 million investment for the Shepparton Rail Line Upgrade in the 2020 Budget. This will ensure that the rail corridor between rural Victoria and Melbourne will run more reliably, enabling the transportation of goods and people to be more timely, consistent and efficient. This is an example of an aggregate supply policy that increases productive capacity of the Australian economy, as improved transport services decrease the time and cost associated with production of goods and services and enable production to increase.

With an improvement in the productive capacity of the Australian economy, there will be positive benefits associated with trade liberalisation. Trade liberalisation is any government initiative that is designed to promote free trade between countries. When the Australian economy has increased productive capacity, it is able to produce more items at a more competitive price and can therefore compete with other producers of goods and services around the world.

This will likely have flow-on effects to improving living standards. The Shepparton Rail Line Upgrade will likely provide more satisfied commuters through shorter travel times, which improves satisfaction levels and living standards directly.

6 marks

1 mark for explaining aggregate supply.

1 mark for defining productive capacity.

1 mark for describing how aggregate supply policies increase productive capacity.

1 mark for providing an example of an aggregate supply policy increasing productive capacity.

1 mark for explaining how increased productive capacity improves trade liberalisation.

1 mark for explaining how increased productive capacity improves living standards.