

ECONOMICS
Unit 3&4 Examination 2
MARKING GUIDE

SECTION A – Multiple-choice questions**Instructions for Section A**

Answer **all** questions in pencil on the answer sheet provided for multiple choice questions

Choose the response that is correct or that best answers the question

Correct answers score 1, while incorrect answers score 0

No marks will be deducted for incorrect answers

No marks will be given if more than one answer is given for any question.

Question 1

From the list below, select the situation that best represents an example of opportunity cost:

- A. A business chooses to use its resources to produce a product which is not popular with consumers, and makes a loss of \$15 000.
- B. A person chooses to go cycling and consequently gets wet from the rain.
- C. A government chooses to allocate \$2 million towards building a new hospital, so sacrifices the new school that could have been built with the money.**
- D. A business chooses to lower the price of its product by 10% and gains 20% more customers.

Question 2

Which of the following markets is the closest example to a perfectly competitive market?

- A. The market for carrots.**
- B. The market for bicycles.
- C. The market for air fares from Sydney to Melbourne.
- D. The market for houses in Melbourne.

Question 3

Which of the following is **not** a source of government revenue?

- A. Welfare payments**
- B. Goods and services tax (GST)
- C. Excises
- D. Income tax

Question 4

A deterioration in Australia's terms of trade:

- A. would likely lead to an increase in the current account surplus.
- B. **could be caused by an increase in demand for Australia's major exports.**
- C. would likely lead to an increase in the capital and current account deficit.
- D. could be caused by higher prices of Australia's imports.

Question 5

Refer to Table 1:

Table 1: Consumer Price Index (CPI) Data for a hypothetical economy

Year	CPI
2019/20	310
2020/21	350

What is the inflation rate for 2020/21 for the above hypothetical economy?

- A. 0%
- B. 11.4%
- C. **12.9%**
- D. 8.8%

Question 6

Which of the following is an example of an automatic stabiliser?

- A. Income tax revenue rises as the business cycle contracts.
- B. **Welfare payments rise as GDP falls.**
- C. Discretionary spending on infrastructure rises as GDP falls.
- D. Net exports fall as the Australian dollar appreciates.

Question 7

Which of the following combinations of factors would have the most positive impact on Australia's aggregate supply?

- A. A decrease in population and an increase in productivity.
- B. An increase in the labour force participation rate and lower input prices.**
- C. A depreciation of the Australian dollar and increases to company tax rates.
- D. An increase in productivity and a severe drought.

Question 8

An increase in the price of Product X is most likely to result in:

- A. a rightward shift of the demand curve for Product X.
- B. a rightward shift of the supply curve for Product X.
- C. a movement up along the supply curve for Product X.**
- D. a movement up along the demand curve for Product X.

Question 9

Which of the following combinations of factors are best described as factors that influence non-material living standards?

- A. Access to goods and services; literacy rates
- B. Environmental quality; level of income
- C. Crime rates; mental health**
- D. Level of income; life expectancy

Question 10

Cost inflation could be caused by:

- A. an increase in transfer payments to households.
- B. an increase in wage rates.**
- C. a decrease in income tax rates.
- D. an increase in aggregate demand.

Question 11

A manufacturing business pays a supplier to install new machinery in a factory. This transaction would be:

- A. included in the Investment (I) component of GDP.**
- B. included in the Consumption (C) component of GDP.
- C. included in the Government (G) component of GDP.
- D. not included in GDP.

Question 12

Failure to achieve the macroeconomic goal of full employment is likely to result in

- A. an increase in the inflation rate.
- B. a decrease in the budget deficit.
- C. an increase in income inequality.**
- D. an increase in productive efficiency.

Question 13

Refer to Table 2.

Table 2: Employment data for a hypothetical economy

Working age population	20 million
Labour force	14 million
Employed people	13 million
Underemployment	2 million
Hidden unemployment	0.5 million

What is the unemployment rate for the above hypothetical economy?

- A. 14.2%
- B. 7.1%**
- C. 3.5%
- D. 10%

Question 14

Which of the following factors would be **unlikely** to cause an increase in aggregate supply for Australia?

- A. A decrease in the global oil price.
- B. Lower company tax rates.
- C. An increase in government spending on research and innovation.
- D. A decrease in the number of skilled migrants moving to Australia.**

Question 15

It is feared that many jobs will soon be lost to automation, whereby technological advancements will enable machines and robots to perform the roles of human employees. What type of unemployment is this situation best classified as?

- A. Frictional
- B. Cyclical
- C. Hard-core
- D. Structural**

SECTION B – Written responses**Instructions for Section B**

Answer **all** questions in the space provided

Question 1 (15 marks)

In 2020, the Australian government announced the ‘Job-ready Graduates Package’, a plan to increase university funding by \$2 billion by 2024. One of the purposes of the package is to reduce the fees for ‘priority courses’ such as engineering, computing, allied health, nursing and education.

Source: <https://www.dese.gov.au/job-ready>

- a. By referring to market failure, explain why the government subsidises education. 3 marks

Suggested answer

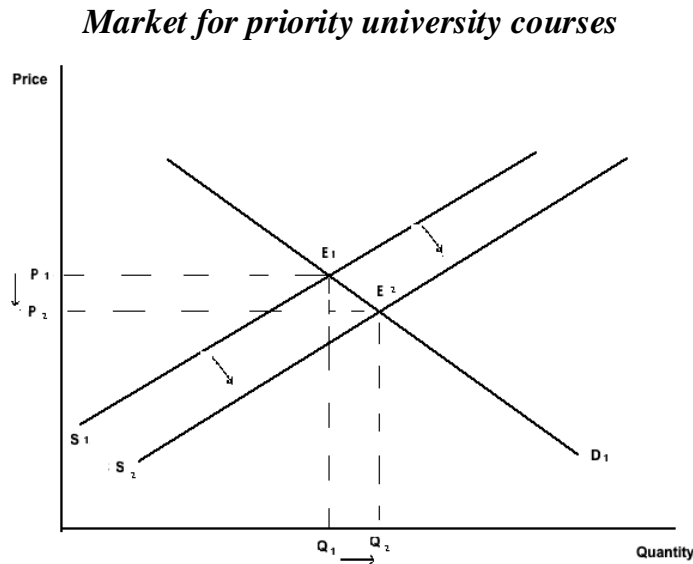
Market failure is a situation in which the free market fails to allocate resources in a way that maximises the welfare of society. (1) In the case of education, there are benefits that exist for third parties, beyond the benefits experienced by the consumer or producer of education, and these benefits are not accounted for by the market, and thus there is an under-allocation of resources towards education. (1) Government subsidies for either the producer or consumer will encourage a greater equilibrium quantity of education and more resources allocated towards it, and thus greater benefits for society. (1)

[1 mark for showing an understanding of market failure; 1 mark for showing understanding of positive externalities and 1 mark for explaining why the government subsidises education.]

- b.** Using a fully-labelled demand and supply diagram, explain the likely effect of the Jobs-ready Graduate Package on resource allocation, and on the equilibrium price and quantity for priority courses. 4 marks

Suggested answer

Diagram showing increase in supply; lower equilibrium price and higher quantity in the market for priority courses (2 marks)



An increase in government subsidies to universities will essentially lower the costs of supplying priority courses, which means supply will shift rightward (increase in supply) (1). This leads to a lower price and a higher equilibrium quantity, thus more resources allocated towards this product/service. (1)

[Alternatively, students may approach this question by assuming the subsidy is given directly to consumers of education, and thus can show and explain an increase in demand and associated change to equilibrium]

- c.** Outline how the Jobs-ready Graduate Package is expected to affect productivity in Australia. 2 marks

Suggested answer

Productivity is measured in terms of the ratio of total outputs to inputs. The package should lead to a more highly-skilled labour force (1), that can improve the contribution workers make to the production process – leading to more output from fewer inputs. This leads to increased productivity rates for Australia (1).

- d.** Besides investing in education or training, explain **one** other type of aggregate supply policy the government could implement to achieve the goals of full employment and strong and sustainable growth. 2 marks

Suggested answer

Investment in economic infrastructure such as roads, railways, ports, electricity, gas and telecommunications can assist Australia in being able to produce more goods and services, through greater productivity and increased stock of capital resources. (1) More production leads to an increased demand for labour and in turn, more spending, which also assists in achieving the goal of full employment. More production amounts to greater levels of GDP, and this is more sustainable if achieved through an increase in aggregate supply rather than increase in aggregate demand only, since demand-side inflationary pressures are offset by productivity gains and lower costs on the supply side. (1)

- e.** Explain **one** strength and **one** weakness of using aggregate supply policies to achieve domestic macroeconomic goals. 4 marks

Suggested answer

Some aggregate supply policies could potentially have the effect of increasing income inequality – such as policies designed to limit welfare in order to increase labour force participation. This may lead to lower material and non-material living standards for some lower-income people who may still struggle to find a job in the short term. (2) On the other hand, such policies can have longer-term benefits in increasing the productive capacity of the economy, leading to lower costs of production, increased demand for labour and less unemployment. (2)

[Any valid alternative strengths and weaknesses can be given, but must be explained adequately for 2 marks each]

Question 2 (18 marks)

- a.** Explain how each of the following factors is likely to affect aggregate demand and the goal of full employment. 6 marks

- (i) A decrease in the value of the Australian dollar
- (ii) An increase in house prices across Australia
- (iii) A fall in business confidence

Suggested answer

A depreciation in the value of the Australian dollar will make Australian exports more attractive to foreigners and will thus increase export demand. Similarly, imports will become relatively more expensive to Australians, decreasing import demand. The effect of this is to increase 'net export demand' and thus aggregate demand. This can have a positive effect on the goal of full employment as more production will occur to meet the increased demand, requiring more labour. (2)

When house prices increase, this essentially increases the wealth held by Australian households. An increase in wealth leads to an increase in consumer confidence and propensity to spend. This has a positive effect on consumption demand, and thus a positive effect on aggregate demand, leading to increased production and demand for labour, and therefore is a positive effect on the goal of full employment. (2)

A fall in business confidence will impact on businesses' decisions about production levels and also new investment in capital resources or other infrastructure. This means a decrease in investment demand and thus a negative impact on aggregate demand. Lower levels of production amount to less demand for labour and thus a negative impact on the goal of full employment. (2)

- b.** Describe the phase of the business cycle known as a 'contraction'. 2 marks

Suggested answer

A contraction in the business cycle occurs after a peak and is a period of lower rates of economic growth (1). In this phase, businesses will be slowing or decreasing their levels of production and demanding less labour, so unemployment increases. A contraction is followed by a trough, in which economic activity hits a minimum point before increasing again (expansion). (1)

- c. Explain the monetary policy stance the Reserve Bank of Australia (RBA) would be expected to take during a contraction, and why, with reference to the role of the RBA as outlined in its charter. 4 marks

Suggested answer

The RBA's charter states that the RBA's main objectives are to contribute to the stability of the currency of Australia; full employment and the economic prosperity and welfare of the people of Australia. Since a contraction is characterised by slowing rates of economic activity, this can have negative effects on the level of GDP and thus on material living standards. To better contribute to the goal of economic prosperity and welfare, the RBA should aim to increase economic activity, and does so by decreasing the cash rate, influencing lower interest rates across the economy. Lower interest rates lead to an increase in aggregate demand, and thus increased production and employment. In addition, a contraction is characterised by low levels of AD and low inflationary pressures, so stimulating AD can be necessary to achieve the RBA's goal of price stability or levels of inflation between 2 – 3% over the course of the business cycle.

[This question should be marked globally. For full marks students should show knowledge of the objectives of the RBA as outlined in the charter; knowledge that expansionary policy is necessary, and why, with reference to aggregate demand and the goals.]

- d. Describe how the RBA uses open market operations to influence interest rates, aggregate demand and the inflation rate. 6 marks

Suggested answer

Open market operations are the transactions undertaken by the RBA to influence the cash rate, which is the interest rate paid by banks in the overnight money market in Australia. If the RBA wishes to increase the cash rate, it will sell securities at an attractive price, leading to an increase in demand in the overnight money market and thus a higher cash rate. This translates to higher interest rates across the economy, which slows aggregate demand in a number of ways. Businesses and households will be less likely to invest or consume, plus a higher interest rate can lead to an appreciation in the Australian dollar (due to foreign investors demanding more of the currency for financial investments) and thus there is a negative impact on net exports. The multiple negative effects on aggregate demand slow down demand-side inflationary pressures, helping to achieve price stability in a situation where inflation was becoming too high.

[This question should be marked globally, but students need to show a similar level of complexity in their response for full marks]

Question 3 (18 marks)

According to Philip Lowe, Governor of the RBA, the following factors have been influencing house prices in early 2021: ‘[R]ecord low interest rates; a shift in preferences towards houses and away from apartments; strong demand for housing outside our largest cities; large government incentives for first-home buyers and home builders; and the slowest population growth in a century.’

Source: Speech- The Recovery, Investment and Monetary Policy.
<https://www.rba.gov.au/speeches/2021/sp-gov-2021-03-10.html>

- a. Referring to the extract above, explain two factors that could have placed upward pressure on house prices. 4 marks

Suggested answer

All else remaining equal, a shift in preferences towards houses and away from apartments amounts to an increase in demand for houses, as more buyers enter the housing market and exit the substitute apartment market. An increase in demand leads to a shortage at the prevailing market price, which leads to a higher equilibrium price in the house market. (2)

Government incentives for first-home buyers are a subsidy for the buyer – the additional funds provided by the government increase their willingness and ability to buy houses, which means demand for houses shifts rightward, leading to an increase in equilibrium price. (2)

[Alternative factors could be record low interest rates or demand for housing outside of cities]

- b. Using an example from the quote from Phillip Lowe, explain how a change in demand in one market can lead to a reallocation of resources and a change in supply in another related market. 3 marks

Suggested answer

An increase in demand for regional houses will lead to an increase in price of regional houses (1). Suppliers (builders) will respond to this by allocating more resources towards building regional houses (1). This leads to fewer resources allocated to building city houses, represented by a decrease in supply of city houses (1).

Alternatively:

An increase in demand for houses (over apartments) will lead to an increase in price of houses (1). Suppliers (builders) will respond to this by allocating more resources towards building houses (1). This leads to fewer resources allocated to building apartments, represented by a decrease in supply of apartments (1).

- c. Discuss whether the demand for houses is likely elastic or inelastic by referring to four factors that influence the degree of elasticity. 5 marks

Suggested answer

Price elasticity of demand reflects the sensitivity of quantity demanded to changes in price, where the more elastic demand is, the more sensitive or responsive it is to price changes. The degree of necessity, availability of substitutes, proportion of income required to purchase and time available are all factors that affect the price elasticity of demand. For houses, while it is necessary to have shelter, it is not necessary to own one's own home, and the shelter needn't be a house – it could be an apartment. So there are many substitutes available – rentals, apartments, and other accommodation. Houses are very expensive and prices are multiple times most people's annual income – mortgage repayments require a large proportion of most people's income. All of these factors point towards the price elasticity of demand for houses being relatively elastic. The longer the time available for a person to make a purchase, the more elastic demand can be. Generally, because there are so many substitutes available, a buyer can take their time to find the best house at the best price, so demand is likely elastic due to this factor too.

[This question should be marked globally. Alternative responses can be considered for full marks but the response must logically apply all four factors that affect the price elasticity of demand, and show adequate understanding on the concept of elasticity.]

- d. Explain the effect of 'large government incentives for first-home buyers and home builders' on the following: 6 marks
- (i) The budget outcome
 - (ii) The goal of full employment
 - (iii) Living standards of Australians

Suggested answer

Large government incentives for first-home buyers and home builders are subsidies that the government must pay for. This means there are additional government outlays, negatively affecting the budget outcome – sending the budget further into deficit if total spending is greater than receipts; or causing a smaller budget surplus. (2)

The incentives amount to an increase in government subsidies for households, which are then spent on new homes being built, so add to the investment (I) component of GDP. This means there is more overall spending and production in the economy, and likely an increase in demand for labour. This will have a positive effect on the goal of full employment. (2)

Due to the increased economic activity and increased jobs available in the construction sector, there will be further increased consumption and it is likely incomes of Australians will rise, leading to improved material living standards. This can have a positive effect on non-material living standards through a reduction in crime, mental health issues, etc. Increased government tax revenue can also assist in providing more public services such as better healthcare and education, further improving non-material living standards. (2)

Question 4 (14 marks)

Refer to Figure 1 and answer the questions that follow.

Figure 1: Australia Balance of Payments Data



Source: adapted from Australian Bureau of Statistics;

<https://www.abs.gov.au/statistics/economy/international-trade/balance-payments-and-international-investment-position-australia/dec-2020>

- a. Referring to the graph above, describe the trend in the current account during 2020. 2 marks

Suggested answer

The current account balance has had an upward trend during 2020 rising to a peak of around \$15bn in early 2020 (1), then falling to around \$11bn, then finishing 2020 at around \$13bn in surplus (1).

- b. Outline two factors for the trend in the current account since the beginning of 2020. 4 marks

Suggested answer

The positive trend in the current account since early 2020 has been due to trade surpluses – where Australia has exported more than we have imported, partly due to exports such as iron ore being strongly demanded by China. (2) Another reason could be due to an increase in net foreign income, involving inflows of foreign income to Australians due to their equity in foreign assets, partly due to the way in which Australian's superannuation is invested overseas. If foreign income earned is greater than income paid out to foreigners, this will have a positive effect on the current account. (2)

[Any two possible or actual reasons that might have a positive effect on the current account can be accepted for full marks, but their effect must be explained logically to show knowledge.]

c. Explain how changes in the current account impact on net foreign debt.

2 marks

Suggested answer

Each quarter that Australia has a current account deficit, this adds to the net foreign liabilities – borrowing from the rest of the world (1). For most of the last few decades, Australia has run current account deficits, and net foreign debt accumulated throughout this time. A current account surplus has the opposite effect – it represents a decrease in net foreign liabilities (1).

d. Evaluate the effect of trade liberalisation on Australia's domestic macroeconomic goals and living standards.

6 marks

Suggested answer

[Students should consider at least two negative effects of trade liberalisation and two positive effects, as well as the effects on goals and living standards, and make an evaluative statement in summary.]

Negative effects of trade liberalisation may include:

- Loss of culture*
- Increase in the power of multinational corporations*
- Loss of local jobs due to structural unemployment*
- Little protection for new industries*
- Increased reliance on other nations in times of crisis*
- Negative effects on the environment due to increased transportation of goods*

Benefits of trade liberalisation may include:

- Increased competition resulting in increased efficiency of local industries*
- Increased economic growth due to greater capacity*
- Increased employment opportunities*
- Increased incomes*
- Lower inflationary pressure due to increased competition and efficiency, economies of scale*
- Greater consumer choice*
- Improved quality of available goods & services*
- Improved material living standards due to more access to goods and services*

While short term job losses may result from trade liberalisation, longer term economic growth should lead to a positive effect on the goals of strong and sustainable growth and full employment. Increased efficiency and competition can lead to lower costs of production and less inflationary pressures. Material living standards should improve due to increased incomes, more access to goods and services at lower prices, and more consumer choice. Non-material living standards may be positively affected if increased incomes and thus tax revenues for government are invested in merit goods and products with positive externalities such as healthcare and education, leading to better life expectancy and higher literacy rates, decreased crime, etc. However, negative effects could occur if local jobs are lost in the short term due to structural change and if infant industries are not protected. There is also the potential for supply issues when there is an increased reliance on other nations for essential goods and services. Overall, there is potential for trade liberalisation to be helpful in achieving macroeconomic goals and improving living standards, but policies must be implemented to ensure protection of essential industries and to ensure short-term job losses are not detrimental.

[This question should be marked globally, but must include multiple pros and cons of trade liberalisation and link to the goals and living standards.]