

# ECONOMICS

## Units 3 and 4 – Trial Examination



## 2024 Trial Examination

### **SOLUTIONS**

#### **SECTION A: Multiple-choice questions (1 mark each)**

##### **Question 1**

*Answer:* D

*Explanation:*

Structural unemployment is most likely to be caused with the removal of protectionist barriers that may protect inefficient domestic industries.

##### **Question 2**

*Answer:* C

*Explanation:*

Option C is the correct as lower rates of underemployment would suggest that more people are working and therefore are generating higher levels of disposable income.

##### **Question 3**

*Answer:* A

*Explanation:*

$(115 - 120) / 115 = -4.3\%$

##### **Question 4**

*Answer:* D

*Explanation:*

An increase in the target cash rate signals bonds to be sold to the private sector in exchange for money, reducing the supply of cash in the money market.

**Question 5**

*Answer: A*

*Explanation:*

Option A is correct as when demand shifts to the left, there will be a natural contraction of supply to meet the new equilibrium point.

**Question 6**

*Answer: D*

*Explanation:*

Option D is the only option which improves both efficiencies. Option B does not incentivise an improvement in dynamic efficiency.

**Question 7**

*Answer: B*

*Explanation:*

A more favourable Terms of Trade indicates higher export prices relative to import prices. This would be recorded as higher credits relative to debits in the Current Account and is the option that is least likely to contribute to a deficit figure.

**Question 8**

*Answer: B*

*Explanation:*

The removal of the LMITO was a structural change in the Budget makeup and resulted in more tax revenue being collected in 2023.

**Question 9**

*Answer: B*

*Explanation:*

Option B is the application of a low degree of spare capacity. The announcement of no further performances leads to the tickets being inelastic in nature.

**Question 10**

*Answer: C*

*Explanation:*

Option C is a protectionist policy that will cause a decrease in technical efficiency within the agriculture market as the level of competition is restricted.

**Question 11**

*Answer: B*

*Explanation:*

A vineyard is likely a private estate and therefore is not considered a public good.

**Question 12**

*Answer: D*

*Explanation:*

The elements of option D are achievable in the short and long term respectively. The alternative options are not entirely correct.

**Question 13**

*Answer:* B

*Explanation:*

Option B is the most accurate statement in the year 2023. GDP was kept within the desired range, (though not strong or sustainable for the period), and inflation was well above 3%. Full employment was not achieved either as the unemployment rate contributed to higher degrees of demand inflation too, thus 'overachieving' the NAIRU.

**Question 14**

*Answer:* D

*Explanation:*

A lower cash rate will result in less foreign investment into Australia, lowering the demand for the AUD and therefore the value of the currency.

**Question 15**

*Answer:* A

*Explanation:*

Due to its impact lag, Monetary Policy can become pro-cyclical and its effects can continue to be felt after the initial issues are addressed.

**SECTION B: Written responses**

**Question 1 (20 marks)**

- a. The term excise tax is given to an additional tax associated with the production or consumption of a good. The tax exists to artificially increase the cost of production/consumption, deterring society away from the demerit good, (such as alcohol).

2 marks

- 1 mark for outlining how the tax is placed on suppliers
- 1 mark for link to stimulus

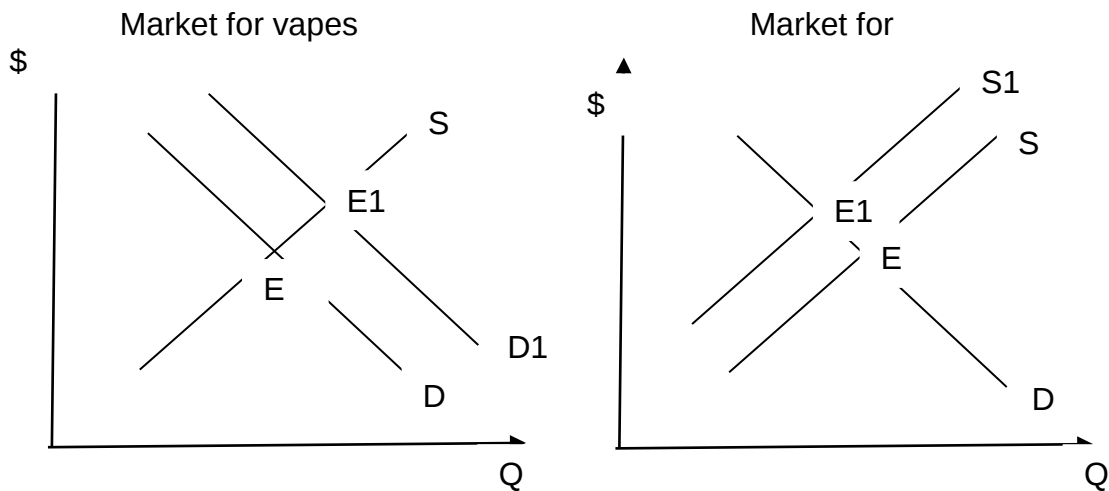
- b. The government has intervened in the market in order to correct a market failure. Demerit goods such as alcohol can create negative externalities such as public intoxication, domestic violence and a range of medical problems. In each of these scenarios, the externality creates a social cost borne by a party that is not involved with the original transaction. In this case, the government has intervened to increase the costs associated with the production of alcoholic products. This extra cost will be passed on from producer to consumer with the aim of deterring consumption. If successful, the intervention slows or stops the frequency that resources are allocated to unproductive means, (such as hospital resources for drinking-related problems which are avoidable), improving the technical and allocative efficiency present within the market.

3 marks

- 1 mark for explaining the market failure of negative externalities
- 1 mark for linking to an appropriate lack of efficiency
- 1 mark for linking to the example

- c. The increase in excise taxes for cigarettes and tobacco-related products is an example of a government failure. While it was done to correct a market failure similar to the negative externalities present with alcohol, the intervention has unintentionally caused further problems and inefficiency in the marketplace. As a result of the increased taxes, consumers have switched to the substitute product of e-cigarettes and vapes. These products were relatively cheaper to purchase but due to the cheap nature of the product and the chemicals used, these products have in many ways created worse health problems at a faster rate. Not only are traditional smokers opting for the substitutes, but due to their popularity, young people who would traditionally struggle to access cigarettes have begun to use these products too. What has resulted is a situation where allocative and technical efficiency is worsened as resources are now being allocated to re-educate the public about the dangers of vaping as well as resources going towards to detection of vapes, (bathroom sensors). This is in addition to the labour and capital being used within the healthcare system to treat people with lung-related problems.

- 1 mark = outlining the failure (the fall in efficiency)
- 2 marks = outlining how the intervention rectifies the inefficiency



6 marks

- 2 marks = Response should include at least one accompanying illustration.  
The illustration should be fully labelled and highlight the disequilibrium
- 2 marks = demonstrate an understanding of a contemporary government intervention
- 2 marks = explanation of how the intervention has unintentionally worsened the situation

d. Alcoholic drinks are traditionally considered elastic drinks when considering the price elasticity of demand. While they are typically deemed as non-essential items, the responsiveness of the demand for them in relation to price is higher than other products such as insulin or petrol. This means that demand falls away at a higher rate; making the product elastic in nature. In addition to this, growing numbers of substitute products are becoming available including pre-mixed drinks and non-alcoholic drinks, allowing consumers to quickly switch to these alternatives if the price for alcohol increases. However, for some consumers, alcohol may be considered more of a need. This includes bars and hotels; suppliers, but not producers, of alcohol. For these parties, hikes in the price of alcohol may not lead to much of a decrease in demand from the wholesaler due to the level of necessity from their perspective.

4 marks

- 2 marks = an explanation of how alcoholic beverages can have a high PED (using a suitable factor)
- 2 marks = an explanation of how alcoholic beverages can have a low PED (using a suitable factor)

- e. Competitive markets, (pure markets), typically operate with high levels of technical and allocative efficiency. This strength is due to the suppliers in the market having to produce at cheaper costs in order to stay competitive with their homogenous products, (as they are only differentiated by price). Additionally, resources tend to be wasted less as they are allocated towards their most productive and profitable use. A disadvantage to a free market like this, is that, due to consumer sovereignty, businesses will answer the 3 basic economic questions and produce according to what is demanded by the consumers. To stay profitable, businesses need to strive to produce according to the relatively higher signals and this can sometimes lead to the production of goods that do not maximise society's wellbeing and living standards, (such as illicit drugs). The production and consumption of these products can lead to market failure, creating inefficiencies within the market mechanism. Whilst competitive markets succeed in the allocatively efficient allocation of resources, there are times where that is also completed by technical efficiency too. It is just worth noting that this isn't always the case due to the unplanned social and financial costs associated with demerit goods.

5 marks

### Marked Globally

- 2 marks = an explanation on how free markets are able to achieve technical and allocative efficiency without the need for government intervention (with examples)
- 2 marks = an explanation of how free markets can fail and worsen efficiency and living standards without government intervention (with examples)
- 1 mark = a final statement of opinion as to the effectiveness of pure markets in allocating resources efficiently

### Question 2 (19 marks)

- a. Across 2023, inflation levels have been much higher than the desired rate of 2-3%. This is largely in part due to supply shocks that have continued on from 2022 after the conflict broke out between Russia and the Ukraine. A consequence of this conflict has been the trade restrictions placed on Russia's oil exports, which consequentially have limited the global supply of oil. This has seen the price of oil and petrol rise around the world, which has contributed to the higher costs of production for almost every industry. From production to transportation and logistics, the entire supply chain of many industries has been impacted, causing pressure on the average price of goods and services to rise. In addition to this, there are many consumers that across 2023 have still had their mortgages and loans fixed at preciously lower interest rates. Though the interest rates have increased over the year, those with fixed rates of interest have been able to hold onto a larger proportion of discretionary income and as such have contributed to the inflationary pressures through their consumption spending. This has provided demand pull pressures in addition to cost push pressure on prices.

5 marks

**Marked Globally**

- 2 marks = an explanation of cost push inflation and how it has worsened over the last 12 months
  - 2 marks = an explanation of demand-pull inflation and how it has worsened over the last 12 months
  - 1 mark = Links to CPI inflation increasing over 2023 (with examples)
- b.** Higher levels of inflation influence distorted spending and investment patterns in the economy. Rates of inflation of above 7% reduce the purchasing power of consumers so many choose to save their money in banks or purchase assets such as gold, silver and real estate as these are good hedges against inflation. While this is possible for some members of the economy, the effects of this behaviour are that distorted price signals are sent to the market. Suppliers will try to provide more of these spending opportunities rather than producing goods and services that are actually needed, (such as basic consumables), as many members of the household sector will have to slow their spending, (and therefore demand signals), due to the increased costs of living.
- 4 marks
- 2 marks = an explanation of one way that either consumer or business behaviour changes with high levels of inflation and how this impacts their decision-making and resource allocation
  - 2 marks = an explanation of one other way that either consumer or business behaviour changes with high levels of inflation and how this impacts their decision making and resource allocation
- c.** Disinflation occurs when the inflation rate slows/falls but still remains positive above 0%. This is different to deflation which is essentially negative growth in the average level of prices. The difference exists where with disinflation, prices are still growing, just at a slower rate whilst with deflation, the prices begin to fall.
- 3 marks
- 1 mark = Stating the meaning of disinflation
  - 1 mark = Stating the meaning of deflation
  - 1 mark = Stating the difference specifically between a fall in CPI growth and negative growth

- d. The Reserve bank of Australia, (RBA), could employ the conventional Monetary Policy of changing the target cash rate and affecting the amount of money in the cash market. By tightening the cash rate, the RBA will be able to sell bonds to the private sector in exchange for cash, this decreases the money in the cash supply and results in these restrictions flowing through the various transmission mechanisms. For example, through the cash-flow mechanism, a higher cash rate will reduce the discretionary income that many consumers have by requiring them to use more of their incomes to service existing loans. This seeks to reduce the inflation caused by excessive spending. While this can be an effective way to slow down consumption in the economy, it does little to effect the inflation caused from supply-shocks and cost-push inflation. In fact, it can often make the situation worse for suppliers who are already struggling with costs, pressuring them to pass these increased costs onto their consumers

4 marks

- 2 marks = an explanation of a strength of conventional Monetary Policy (changing the TCR)
- 2 marks = an explanation of an alternative viewpoint that critiques the conventional policy

- e. As the cash rate is tightened to slow the effects of inflation in the economy, the market for assets such as housing will also be affected. As banks follow suit and increase their interest rates, it makes it harder for prospective buyers to secure a loan to purchase housing. As a result, the demand for property falls, leading to a decline in the value and therefore price of these assets.

3 marks

- 2 marks = demonstrate an understanding that a tighter cash rate affects the demand for assets
- 1 mark = Explicit link to asset values falling as the cash rate increases

**Question 3 (14 marks)**

- a. Between 2022 and 2023 there has been a continued decline in the index of commodity prices from approximately 90 index points to approximately 85 index points. This steep decline is deemed to be unfavourable.

2 marks

- 2 marks = a description of the trend with specific reference to dates and index numbers

- b. A potential reason for this unfavourable trend in commodity prices could be the fall in global demand since 2021. Global economies are still trying to recover from the impacts

of global lockdowns and high levels of inflation. As global confidence continues to be rattled by poor economic conditions and new developments of war and conflict in the world, the demand to invest in infrastructure, (and therefore the derived demand for Australian commodities), falls away and leads to the average price of these commodities falling.

2 marks

- 2 marks = the use and brief explanation of a relevant factor which impacts the TOT  
Negatively (global trade levels, the exchange rate, supply conditions etc.)

- c. A weaker Australian Dollar could impact Australia's Current Account in a few ways. A benefit of a depreciated Dollar is that Australia's exports would be deemed cheaper and more internationally competitive to global buyers and could assist in improving the revenue stream generated by export credits. In addition, the weaker purchasing power would deter as many import debits relative to imports, helping to create a more positive balance or Surplus in the Current Account. Conversely, a weaker Dollar may make it harder for Australia to service its Net Foreign Debt and Primary Incomes obligations as it will cost more Australian currency per unit of currency owed to our investors. This could make it harder to create a surplus in the Current Account.

4 marks

- 2 marks = an explanation of how a depreciating Dollar affects imports and exports
- 2 marks = an explanation of how a weaker Dollar could impact other elements of the Current Account (final deficit/surplus figure, net foreign debt etc.)

- d. The falling commodity prices indicate less revenue is being generated on Australia's export of coal, gas and other commodities. As a result of this, the profits being generated by mining firms will fall as well. The Budget will be affected by fewer revenues relative to receipts and may notice a further decline in receipts if employees in the export sector are made redundant and lose their disposable incomes. This is due to the reduction in income tax and revenue generated by consumer spending too. (e.g. GST). The likely impact of these changes to the Budget are that it can fall into less of a surplus or a deficit.

3 marks

- 1 mark = Stating an impact that a fall in commodity prices will have on the Budget
- 2 marks = further detail on exactly how the Budget will be impacted by a loss of revenue

- e. The cyclical components of the Budget are often referred to as the automatic stabilisers. These are mechanisms, (such as the progressive tax system and the social security system), which operate without the need for government decisions as they have already

been set up to assist the Budget operate in a counter-cyclical way to the nature of economic activity in the economy. As a contrast, the structural components of the Budget are referred to as the discretionary stabilisers as they require governments to make deliberate policy decisions to operate to stabilise economic activity in the economy. These include decisions announced in the Federal Budget announcement each year, as well as decisions to subsidise and/or tax an industry throughout the year.

3 marks

- 1 mark = demonstrating an understanding of the structural component of the Budget is
- 1 mark = demonstrating an understanding of the cyclical component of the Budget is
- 1 mark = Stating the difference

**Question 4 (12 marks)**

- i. An increase in skilled migration to Australia is likely to see increases in tax revenue generated by increased employment and therefore more personal tax revenue. This is because the skilled migration stream is likely to find gainful employment within the country quite quickly due to the demand for their skills. In addition, the growth in population will bring with it an increase in the demand for housing and consumables, further adding to the revenue generated from land taxes and GST. Though this extra revenue could help to generate a Budget Surplus, it may create a Budget Deficit in the short term. This is because higher immigration levels will create a need for greater infrastructure spending in the short term to allow for the expansion of the population. This includes government spending on roads and public transport networks as well as investments into housing developments, parks, schools, hospitals and other economic and social infrastructure.

4 marks

- 2 marks = demonstration of knowledge on the benefits of skilled immigration on the federal government budget outcome
- 2 marks = an alternate explanation of how skilled immigration could negatively impact the government budget outcome

- ii. An increase in skilled migration will help to increase Australia's skilled workforce and therefore in productivity. This should help Australia to improve both its technical and allocative efficiency as it can directly support growing industries with the appropriate skilled labour to improve our productive capacity and output as well as produce more goods and services at cheaper costs per output. The lower costs and increased volume of production should help to develop Australia's international competitiveness as we can now develop an advantage in new sectors of the economy and capitalise on this through increased exports. This does however create a problem for Australia's domestic labour force who, due to an absence of the required skills, may be rendered unemployed, leading to an underutilisation of the domestic labour force.

4 marks

- 2 marks = demonstration of knowledge on the benefits of skilled immigration on the Nations productive capacity
- 2 marks = an alternate explanation of how skilled immigration could negatively impact the nation's productive capacity

**b.** A market-based environmental policy, such as a carbon tax, would help to achieve greater efficiency and living standards within the country. A carbon tax would operate as an excise tax and could be placed on the consumption and/or the production of carbon emissions. In the case of production, the tax would penalise producers for excess emissions and would effectively increase their costs of production, hurting their technical efficiency in the short-term. This is because the tax would shift the supply of production to the left, increasing the equilibrium price and reducing the quality simultaneously. This would have the follow-on effect of contracting the demand for carbon-based production at such a relatively higher price.

In the long-term, this would assist firms to become more intertemporally efficient, improving the methods of production and ideally making them 'greener'. This would preserve enough resources for future generations whilst being able to utilise enough of them for the present consumption needs. This initiative would see new jobs being created in the green energy sector, improving material living standards through increased employment opportunities and incomes. It would also see levels of pollution and environmental degradation fall, improving non-material living standards too.

- 2 marks = Description of a suitable market-based policy (must refer to the market mechanism forces)
- 1 mark = Link to the impact on intertemporal efficiency
- 1 mark = Link to the impact of living standards