ECONOMICS

Unit 1 – Written examination

TSSM™
Creating VCE Success

2017 Trial Examination

SOLUTIONS

SECTION A: Multiple-choice questions

Question 1
Answer: D
Explanation:
Financial resources refer to money. Money is a medium of exchange and a measure of value and not a resource as such.

Question 2
Answer: C
Explanation:
Our market system uses the decisions of consumers and suppliers to allocate resources. What consumers demand determines what suppliers supply.

Question 3
Answer: B
Explanation:
Opportunity cost refers to the cost of foregoing an alternative use of resources or money – it is what is given up or foregone by using resources or money in one way instead of another.

Question 4
Answer: A
Explanation:
By holding on to the guitar the person is foregoing the opportunity of selling it and receiving $500.

Question 5
Answer: D
Explanation:
Using funds to build a hospital is the next best alternative of building a freeway and so this is the opportunity cost.

Question 6
Answer: B
Explanation:
If resources are not used efficiently then production won't be maximised

Question 7
Answer: B
Explanation:
Scarcity refers to a situation where resources used in production are scarce relative to their use or the wants they can produce.

Question 8
Answer: D
Explanation:
The price mechanism determines what will be produced through the choices made by consumers. Price determines who is able to afford to purchase these goods and services so all options are correct.

Question 9
Answer: D
Explanation:
Consumer preferences determine demand and hence supply and by extension where resources are allocated.

Question 10
Answer: C
Explanation:
If the cost of producing soft drinks increases, these costs are usually passed on to consumers in the form of higher prices.

Question 11
Answer: C
Explanation:
Human resources are also known as labour and are primarily used in labour intensive production.

Question 12
Answer: C
Explanation:
The role of the price mechanism is to determine what will be produced. Using information provided by consumers and suppliers, prices for goods and services will be supplied and purchased in quantities and at prices that satisfy as many economic agents as possible.

Question 13
Answer: D
Explanation:
If the cost of supplying a seat on an airplane decreases then more will be supplied as the airline can produce more for the same cost.

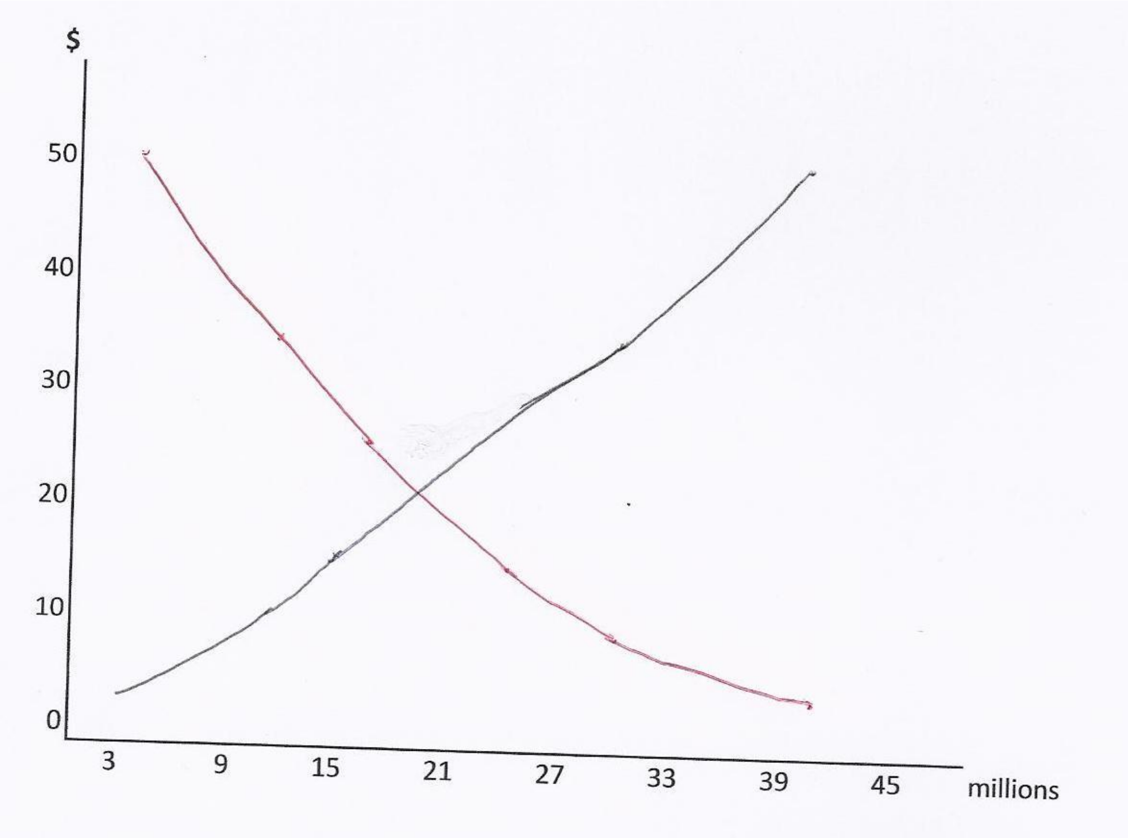
Question 14
Answer: D
Explanation:
In a two sector economy there is no external sector and so there is no spending on imports.

Question 15
Answer: A
Explanation:
Perfect competition requires many buyers and sellers so that all businesses can compete freely.

SECTION B – Short Answer Questions

Question 1

a.



4 marks

b. The equilibrium price is $21 approximately.

1 mark

c. The equilibrium quantity is 18 units approximately

1 mark

d. Equilibrium refers to a point where the forces of supply and demand are 'equally' matched, and where the market is 'cleared' and agreement is reached between buyers and sellers of goods and services. The price at which this takes place is called the 'equilibrium price', and the volume involved is called the 'equilibrium quantity' (the quantity supplied exactly equals the quantity demanded).

2 marks

e. A minimum price of $10 would see demand for the DVDs exceed supply because at $10 the quantity demanded would be 30 million DVDs demanded but only 12 million supplied.

2 marks

f. If the price was set at $30 there would be a surplus of DVDs as supply would be 25 million units but demand would only be 14 million. The price would fall until the surplus was purchased and the market was cleared.

2 marks

g. A demand schedule shows the quantity that will be demanded at each given price provided. It is presented in a table form.

2 marks

Question 2

a.

- An increase in disposable income means people who previously couldn't afford avocados may now be able to. This will increase the demand for the product.
- A decrease in the price of a substitute fruit will make the substitute fruit more appealing from a price perspective increasing its demand while decreasing the demand for avocados.
- An increase in interest rates means that households may be spending more on repaying debt leaving less disposable income for the purchase of fruit. Hence the demand for avocados should decline.

3 x 2 = 6 marks

b. A shift in the demand curve occurs when the quantity demanded at any given price changes. This is a result of changed demand conditions. The whole curve is shifted left (a decrease in demand) or right (an increase in demand). A movement along the demand curve is when the price of the product changes and so the demand rises or falls – no new curve is created.

2 marks

Question 3

a.

- A severe drought means crops will likely fail and less wheat will be harvested and so the supply of wheat will fall.
- Interest rates are a cost of production and so a rise in costs will see a decrease in supply as it is more expensive to grow wheat.
- A new strain of wheat that increases the yield means the supply of wheat will increase as more wheat is grown per hectare.

3 x 2 = 6 marks

b. A shift in the supply curve occurs when the quantity supplied at any given price changes. This is a result of changed supply conditions. The whole curve is shifted left (a decrease in supply) or right (an increase in supply). A movement along the supply curve is when the price of the product changes and so the supply rises or falls – no new curve is created.

2 marks

Question 4

a. The private sector and the public (government) sector

1 + 1 = 2 marks

b. The purposes for which an economy will use its scarce resources, including land and natural resources, labour and entrepreneurial skills, and capital goods and technology to produce goods and services.

2 marks

c. An economic system where most decisions about what to produce, how to produce (i.e. production methods) and for whom to produce are made through the free operation of the price or market system. Allocation of resources is determined by prices in the market.

2 marks

d. Market power exists when a firm has much control or influence in a market (it is a price maker) because competition is limited and it has a monopoly or is an oligopoly.

A monopoly is a situation where there is only one seller in a market and so is able to act as a price maker – they set the price, as there is no competition. Hence in this situation the firm has a high degree of market power.

In a perfectly competitive market system there are a large number of firms and so there is strong competition. Firms become price takers as consumers have options and so the firms have little market power.

4 marks

Question 5

i. Utility maximization refers to the concept that each product consumed provides some satisfaction for a consumer. Consuming additional quantities of a product will continue to satisfy a consumer but the satisfaction level will diminish – you can only have so much of something before it no longer satisfies. Consumers consider how much satisfaction they want and how much they will receive and so their decisions are affected by how much additional satisfaction they will receive from additional purchases of the same good or service.

ii. Each individual will have an income and a set of expenditures they must make out of that income. The expected income and expenditure of a consumer is known as a budget and each person's budget places limitations on the consumption of that consumer. Consumers can increase their spending through borrowing but this restricts their expenditure in the future as the borrowing must be repaid. So consumers must consider their budget as they consider their expenditure and their decisions.

2 x 4 = 8 marks

Question 6

a. Positive economics statements state facts and give no indication of an endorsement or disapproval where normative economics is subjective and values based. One example of a normative economics statement is that lower cash rates leads to an improved quality of life for all Australians. By contrast a positive economics statement would be that a lower cash rate leads to an increase in discretionary income (income left after paying loans etc). The first statement is a claim while the second statement is definitive and scientific.

3 marks

b. The two sector model of the economy is a simplified version of our economic system that is used to explain how our economic system operates. In this model it is assumed there are two sectors (groups) who interact. These interactions are referred to as flows and there are four flows between the two sectors. The two sectors are the household sector who provide resources and then demand goods and services and the business sector who provide income to the household sector and then the goods and services demanded by the household sector.

In this simple and partly unrealistic model of our economy where there is no overseas trade or saving, these four flows are seen as being of equal value (measured in dollar terms). It also means that the four flows are also interdependent, so if one changes, the others must also change either upward or downwards in value, to again restore equality between the flows.

4 marks

c. Living standards refers to a measure of how well-off a nation is overall. There are two types of living standards that are measured:
- material living standards – the volume/amount of goods and services each person has or the economy as a whole can produce; and
- non-material living standards - subjective elements including levels of happiness, job satisfaction, crime, environmental health, urban congestion, hours of work and leisure, family tensions, stress.

3 marks

Question 7

a. The traditional viewpoint of businesses in the economy is profit maximisation. Profit maximisation is where a firm tries to make the largest profit it can by boosting sales and keeping production costs low. This is how consumers see businesses and so they act accordingly. However, businesses also must operate within government rules and regulations, within a particular market structure and are affected by actions of bodies such as unions and the media.

3 marks

b. In recent times businesses have been influenced by a number of 'new' factors and this may have changed the way they operate. Two such factors are sustainability and innovation.
Businesses have recognised that some resources are non-renewable and some production causes damage to the environment. For long term profitability many businesses have embraced sustainability – the concept that production should not just be for now but for the future and businesses need to ensure they allow for production in the future. This can add to the cost of production and so can reduce profits.
A second changing goal of a business is innovation. Innovation is the concept that businesses need to develop new products, new processes and new production methods. This innovation can lead to new markets being developed, greater revenue and profits. However, innovation can have high initial costs and this can be a deterrent to a business if they don't see the profits outweighing the costs.

5 marks

