

ECONOMICS

Unit 2 – Written examination



2017 Trial Examination

SOLUTIONS

SECTION A: Multiple-choice questions

Question 1

Answer: B

Explanation:

Economic activity is directed towards satisfying wants. Individuals use income to satisfy their wants and their demand for goods and services encourages production of goods and services by businesses. Businesses will employ factors of production to meet consumer demand. Wages are earned by labour resources and profits are earned by owners of capital resources. Governments will also receive money through taxation. This income is then spent by individuals, businesses and governments to satisfy more wants, which will generate more demand, production and economic activity. Therefore, economic activity by all of these parties generates production, income, employment and expenditure.

Question 2

Answer: B

Explanation:

The volume of goods and services a person is able to purchase is an indicator of a person's material living standards.

Question 3

Answer: D

Explanation:

The first three options can measure our overall well-being. Unemployment levels link to income and the ability to purchase goods and services – an indicator of material living standards.

Question 4

Answer: D

Explanation:

An efficient allocation of resources occurs when productive inputs such as labour, land and capital are used in a way that ensures maximum satisfaction of wants by consumers.

Question 5

Answer: D

Explanation:

The level of household disposable income influences C; the level of business confidence impacts on I and the level of government expenditure on capital equipment such as roads, ports and railways affects G₂. The level of productivity of the labour force is a factor that affects aggregate supply, not aggregate demand.

Question 6

Answer: A

Explanation:

An increase in government welfare payments and a decrease in personal income tax rates will increase the personal disposal income of households, thereby increasing the private consumption (C) component of aggregate demand. This will encourage an increase in economic activity. An increase in interest rates, particularly with respect to borrowings, has the effect of lowering household income and/or business profits and discourages economic activity. An increase in the exchange rate, or appreciation, tends to slow exports and raise imports. This has the effect of slowing aggregate demand and economic activity.

Question 7

Answer: C

Explanation:

A rise in the cost of materials can lead to a reduction in profit levels and makes businesses less willing and able to produce competitively. Both interest rates and labour costs represent a cost of production and a fall in either of these will increase profitability and encourage higher levels of production of goods and services. A rise in the participation rate represents an increase in the size of the workforce and greater availability of labour. This helps to expand productive capacity and, therefore, increase aggregate supply and economic activity.

Question 8

Answer: C

Explanation:

Increase in participation rates results in a larger pool of productive resources that can be accessed by producers to lift output. It also means that valuable labour resources are fully employed rather than being wasted as unemployed.

Question 9

Answer: B

Explanation:

The move suggested will make income more equitably distributed as high income earners will have less disposable income and low income earners will gain disposable income. This will move the Lorenz Curve closer to the line of perfect equity – closer to 1.

Question 10

Answer: B

Explanation:

The Australian Government hopes to ensure that there is an equitable distribution of income so that everyone has access to basic goods and services such as essential food, education, health and housing. If this occurs, everyone would enjoy at least a reasonable minimum standard of living and there would be no absolute poverty. Equity does not mean total equality in incomes and wealth in a market capitalist economy such as Australia.

Question 11

Answer: D

Explanation:

Market income is the income earned through productive efforts of individuals. Gross income is market income plus the receipt of direct cash welfare benefits. Disposable income is gross income minus the payment of personal income tax. The social wage income is disposable income plus the receipt of indirect non-cash benefits including government community services.

Question 12

Answer: C

Explanation:

The Henderson Poverty Line is based on an index of per capita household disposable income. Updating poverty lines according to changes in per capita household disposable income means that the poverty line is a relative measure of poverty. As real incomes in the nation rise, so too will the poverty line.

Question 13

Answer: D

Explanation:

Globalisation involves all of the features identified – it involves increasing the size of the market so that it becomes one market. This is facilitated by transnational companies and the ability of money and capital to move freely between countries.

Question 14

Answer: A

Explanation:

Globalisation has contributed to a fall in the level of general price rise due to improved efficiency in the Australian industry. Inflation fell on average by almost 70% during the 1990's.

Question 15

Answer: C

Explanation:

Means testing of the baby bonus ensures that low income earners are the recipients of this outlay. A decrease in tax rates is applicable to all irrespective of incomes. Therefore the answer is C as this measure will decrease the gap between high and low income earners.

SECTION B – Short Answer Questions

Question 1

- a. Economic growth occurs when an economy increases the volume of goods and services produced over a period of time. 2 marks
- b. Sustainable development occurs when the economic growth of an economy is sufficient to meet the needs of the present population, without jeopardising the ability of future generations to meet their needs, ensuring continuing resource availability and/or avoiding resource depletion. 2 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.
- 6 marks

Question 2

Limitations for GDP measurement include:

1. Excluded production – not all goods and services are included in the calculation because they are too difficult to calculate. The main examples are illegal production as part of the black economy, cash economy production and household or non-market activities.
2. Imputed production – some production must be estimated because it is not sold in the normal way. Examples are government services that are provided free of charge, and farm production produced on the farm
3. Quality changes – GDP does not specifically measure the change in the quality of goods and services.
4. Distribution of the costs and benefits – GDP does not reveal how the growth in the economy is distributed amongst people within the economy.
5. International comparisons – the calculation of GDP is not the same in every country so comparisons are not always valid or statistically accurate.
6. Living standards – GDP doesn't report changes in living standards and an increase in GDP does not automatically mean an increase in living standards. GDP can be achieved by an increase in working hours at the expense of leisure time and quality of family life.

4 marks

Question 3

Aggregate Demand refers to the total demand for final goods and services in an economy at a given time. There are five components to Aggregate Demand, expressed as $AD = C + I + G + X - M$.

C = Private (Household) Consumption Expenditure. This is the money spent on Australian made goods and services by Australians. It includes expenditure on consumer durable and non-durable goods and services such as food, clothing, housing and cars.

I = Private Investment Expenditure. This is expenditure by individuals and businesses on capital goods such as machinery, factories and buildings. This expenditure aims to increase productivity capacity and productivity.

G = Government (Public) Expenditure. This category is divided into 2 parts:

G_1 - Government Current Expenditure which is expenditure by the government on goods and services that are not capital in nature, such as the operating costs of schools, defence, public services.

G_2 - Government Capital Expenditure which is government spending on capital items such as the provision of hospitals, schools, infrastructure.

X = Exports which is expenditure on Australian produced goods and services by the overseas sector.

M = Imports which is expenditure by Australians on goods and services produced overseas.

8 marks

Question 4

Economic growth has benefits and costs for a country. The **benefits** of economic growth include the following:

1. Economic growth provides more and better goods and services, which means higher living standards (healthier, more secure, etc) for the people of the country.
2. Economic growth provides the opportunity to increase the material possessions of people, without reducing the living standards of others.
3. Economic growth provides the opportunity to reduce inequality and eliminate poverty.

8 marks

Question 5

Economic prosperity is taken to mean having high incomes per person and being able to consume or purchase more goods and services, now and into the future. It is a goal of individuals within the economy. On the other hand, environmental sustainability involves increasing economic prosperity indefinitely into the future. The level of economic prosperity may need to be tempered as too much growth can result in the depletion of non-renewable resources, pollution and urban sprawl, all factors that negatively impact our prosperity.

3 marks

Question 6

- a. Absolute poverty is the absence of the necessities of life due to very low incomes, whereas relative poverty means that living standards are austere; usually less than 50 percent of average weekly earnings. 2 marks
- b. Equity in the distribution of income refers to how fairly/equitably productive income is shared amongst all members of the economy. Governments aim, to not distribute the income evenly, but to reduce inequities where possible. 2 marks
- c. In the 1960's Professor Henderson developed a means of determining if people were living in poverty (or below the poverty line) by determining the amount of money required by different-sized income units each week to sustain an austere or very basic living standard (i.e. to purchase essential food, shelter and clothing, normally set at just 50 per cent of average Australian incomes). In 2016 it was estimated that a standard income unit of four (consisting of two parents, one working, plus two dependent children) would need over \$986 per week to stay above the poverty line. 3 marks
- d. People who are considered poor or living below the poverty line would have lower material and non-material living standards. They would be less able to purchase goods and services, reducing their material living standards. The stress of living below the poverty line, reduced access to health care and the possible need to live further away from the CBD (where rents may be cheaper) can reduce the non-material living standards of people. 3 marks

Question 7

- a. The allocation of resources refers to which sector, private or public sector, determines what use the resource is put to. Under normal circumstances, the group that owns the resources is able to determine to what use those resources are allocated to. 2 marks
- b. Allocative efficiency means that scarce resources are used where they are most wanted or valued by consumers. This generally occurs through the operation of a market system.
Technical efficiency means that when a business makes a decision about how to produce a good or service, it will select the cheapest method whether it involves using labour or machinery. 2 marks
- c. A benefit of achieving allocative efficiency is that more wants and needs can be satisfied, increasing the satisfaction of consumers. 2 marks

Question 8

- a. Earned income is the income derived by a person utilising their labour – either directly (self-employed) or indirectly (employed by a business). Wages and salaries are two examples. Unearned income is income derived from allowing other economic agents to use resources owned by a consumer. An example is rent, earned by a consumer by allowing another person to use their property.

3 marks

- b. Disposable income is the income a person has available to spend after income tax has been deducted by the government. The government seeks to achieve some degree of income equity through using a progressive tax system whereby the percentage of tax imposed increases as incomes increase.

3 marks

Question 9

- a. Local markets – are markets limited in size and operation to a local area or national boundary whereas global markets are markets that operate across international borders.

4 marks

- b. Student responses will vary according to the global economic issue studied.

6 marks

Total 65 marks