

ECONOMICS
Unit 3&4 Examination 3
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

In the market for new cars, an increase in consumers' disposable income is most likely to lead to:

- A. a movement up along the demand curve.
- B. more elastic demand.
- C. a shift to the right of the demand curve.**
- D. a shift to the right of the supply curve.

Question 2

Dynamic efficiency is best described as:

- A. the ability for an economy to quickly move resources to achieve a point of allocative efficiency.**
- B. a situation in which resources are allocated towards production of goods and services that most maximises living standards and welfare.
- C. the optimal use of resources towards both current production and future production.
- D. a situation that occurs when costs are minimised and outputs maximised.

Question 3

Automatic stabilisers are:

- A. government policies that aim to increase aggregate supply so as to stabilise the business cycle.
- B. changes to the case rate to maintain a stable price level across the economy.
- C. trade liberalisation agreements with foreign nations.
- D. changes that are built into the budget and operate without any government action, and act in a counter-cyclical manner.**

Question 4

Which of the following is most likely to lead to an improvement in material living standards for Australia?

- A. A rising labour force participation rate
- B. A fall in import prices relative to export prices**
- C. Increased carbon emissions
- D. Falling literacy rates

Question 5

Covid-19 vaccinations such as Pfizer and AstraZeneca:

- A. are a type of public good since they are provided by the government.
- B. will likely be undersupplied by the free market, causing market failure.**
- C. will always be supplied in sufficient quantities by the free market, so there is no need for government intervention.
- D. will be abundant in markets, leading to lower prices and lower costs of production.

Question 6

Failure to achieve the goal of full employment can:

- A. be caused by an expansion in the business cycle.
- B. lead to greater income inequality.**
- C. lead to an increase in tax paid by employees.
- D. lead to an improvement in material living standards.

Question 7

Complete this sentence: The price elasticity of demand for designer clothing is _____ than that for healthcare because _____:

- A. lower; designer clothing is less expensive than healthcare.
- B. lower; there are more substitutes for designer clothing than healthcare.
- C. higher; designer clothing is less necessary than healthcare.**
- D. higher; designer clothing is more durable than healthcare.

Question 8

Which of the following factors would have a different effect on Australia's aggregate demand than the other three?

- A. A fall in interest rates
- B. An increase in government spending
- C. An increase in income tax rates**
- D. Depreciation of the Australian dollar

Question 9

Which of the following is **not** likely to result from increased spending on research and development?

- A. A decrease in allocative efficiency**
- B. Lower levels of inflation
- C. Improved material living standards
- D. An increase in productivity growth

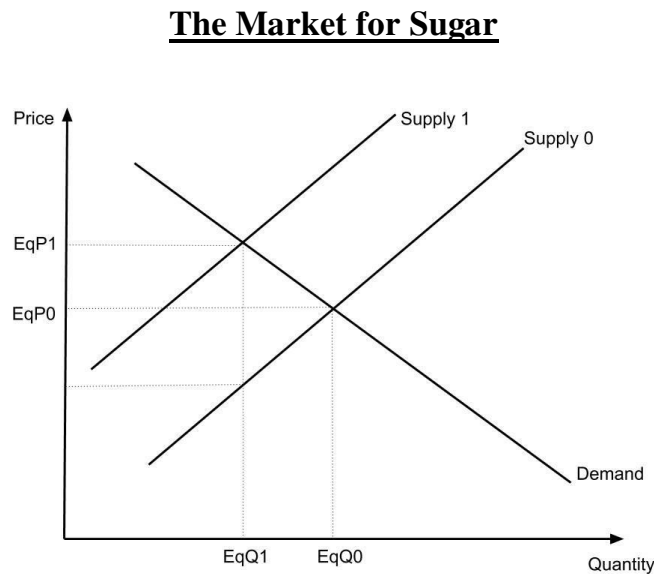
Question 10

An increase in aggregate supply is most likely to occur as a result of

- A. an increase to tax offsets for low and middle-income earners.**
- B. a decrease in skilled labour migration.
- C. an increase in consumer confidence.
- D. a depreciation of the Australian dollar.

Question 11

Refer to the diagram below.



Which of the following could have caused the change shown in the above diagram?

- A. Improved growing conditions
- B. Labour productivity growth
- C. A subsidy for consumers of sugar
- D. An excise tax on sugar**

Question 12

According to the circular flow model, which of the following combinations is most likely to result in leakages being greater than injections to the circular flow of income?

- A. An increase in export volumes and a decrease in government spending
- B. An increase in household savings and a decrease in business investment**
- C. An increase in both import and export volumes
- D. A decrease in household savings and an increase in income tax rates

Question 13

Hard-core unemployment is best described as unemployment that occurs when:

- A. there are changes to the structure of the economy
- B. an individual is physically or mentally unable to hold a job.**
- C. people not working become discouraged and stop looking for work.
- D. employed people would prefer to be working more hours than they currently are.

Question 14

In Product Market X, what would be the effect of a fall in the price of substitute product Y?

- A. A leftward shift in demand for Product X and a fall in the price of Product X.**
- B. A leftward shift in supply of Product X and a fall in the price of Product X.
- C. A rightward shift in demand for Product X and a rise in the price of Product X.
- D. A rightward shift in supply of Product X and a rise in the price of Product X.

Question 15

Refer to the table below.

Table 1: Index of export and import prices for hypothetical economy

Year	Index of import prices	Index of export prices
1	100	100
2	108	103

Which of the following statements is most likely **correct** in relation to the hypothetical economy shown above?

- A. More imports can be bought with a given level of exports in year 2, when compared with year 1.
- B. The terms of trade for the hypothetical economy have deteriorated.**
- C. Living standards have likely improved in the hypothetical economy.
- D. The current account deficit for the hypothetical economy has likely decreased.

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

Answer **all** questions in the space provided

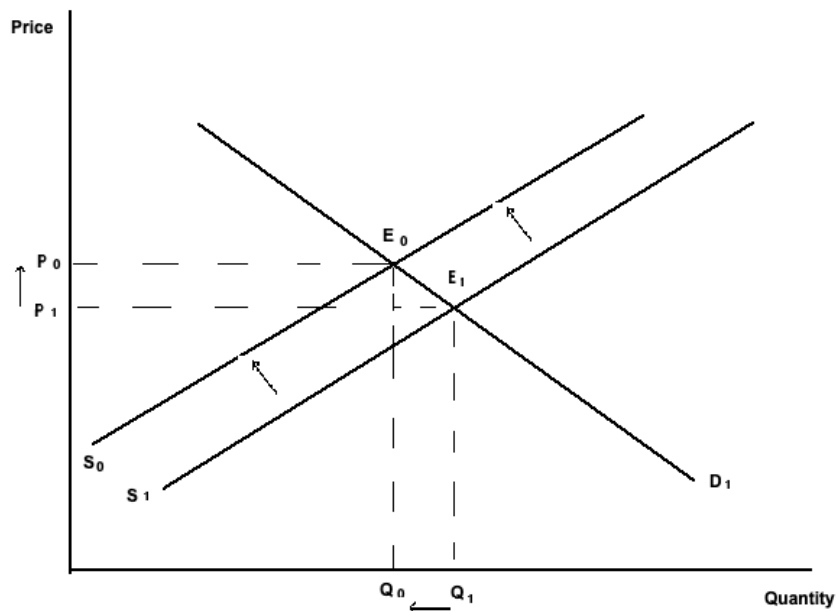
Question 1 (14 marks)

Due to closed international borders in 2020/21, Australian farmers have struggled to find fruit pickers since these seasonal jobs are often filled by international backpackers. Consequently, fruit such as strawberries has been left to rot on some farms.

- a. Using a fully labelled demand and supply diagram, illustrate and explain the effect of the above scenario on the market for strawberries in Australia. 4 marks

Suggested answer

Diagram showing decrease in supply; higher equilibrium price and lower quantity in the market for strawberries (2 marks)

Market for strawberries

Due to the lack of available labour, strawberry farms will be unable to supply as many strawberries, so the supply curve will shift leftward. This leads to a shortage of strawberries at the prevailing equilibrium price, leading to an upward pressure on its price. The end result is a higher equilibrium price and lower equilibrium quantity in the market. (2)

- b. Explain whether the price elasticity of the supply of strawberries is likely elastic or inelastic and justify your answer by outlining **one** reason. 3 marks

Suggested answer

Price elasticity of supply refers to the responsiveness of quantity supplied to a change in price. Supply is said to be elastic when a change in price leads to a greater percentage change in quantity supplied; and inelastic when a change in price leads to a smaller percentage increase in quantity. (1) Items that can be stored for long periods without deterioration are likely to have a more elastic supply. (1) This is because suppliers can store the product and wait for an increase in price so as to make the products available for sale then. Strawberries are not able to be stored for long periods, so likely have inelastic supply. (1)

[Alternative responses can be given, but students must show knowledge of price elasticity of supply (1); describe a factor that influences PES (1); and apply that factor to strawberries (1).]

- c. Despite fruit picking jobs being available on Australian farms, unemployment still exists in Australian cities. Outline the type of unemployment this situation is best described as. 2 marks

Suggested answer

This can be described as structural unemployment (1) – a situation in which the available jobs in an economy are mismatched with the skills or location of the available labour resources (unemployed people) (1).

- d. Discuss whether or not the market for strawberries is a perfectly competitive market. 5 marks

Suggested answer

A perfectly competitive market is one in which there are many buyers and sellers, there is ease of entry and exit (no barriers), homogenous products and perfect knowledge. Strawberries can be considered close to homogenous product as all strawberries are almost exactly the same, although there may be very slight differences in terms of some being grown organically plus there are slight variations in varieties. There are many buyers and also many sellers, since there are low barriers to entry to grow strawberries. There are some barriers though since a seller would need to have access to land and other resources in order to start supplying strawberries. Buyers and sellers do not have perfect knowledge, but it would be quite easy to compare strawberries and prices of different sellers, so knowledge is close to perfect. Overall, in terms of the main characteristics, the market for strawberries is not perfect competition, but close to it – so it is a relatively high competitive market.

[Marks are allocated as one mark per characteristic applied to strawberries, plus one mark for a statement acknowledging that it is a close to perfect or highly competitive market.]

Question 2 (16 marks)

In 2020, the Australian government announced the HomeBuilder scheme, a policy whereby the government would offer \$25 000 subsidies to eligible people for the purpose of building or renovating a home.

- a. Explain how HomeBuilder subsidies will affect each of the following: 6 marks
- (i) The price of newly-built houses in Australia
 - (ii) The budget outcome
 - (iii) The goal of full employment

Suggested answer

A subsidy for home buyers essentially increases the price buyers are willing and able to pay for a newly-built house. This shifts the demand for houses rightward (an increase in demand). This leads to a higher equilibrium price for houses. (2)

The budget outcome is influenced by government receipts and government outlays. Subsidies for home builders are outlays that will have a negative effect on the budget outcome. If total outlays are greater than receipts, the budget will be in deficit. (2) [Alternatively, responses may consider the extra tax revenue generated by the extra economic activity that will offset the initial outlays of subsidies, but this is not necessary for full marks].

The HomeBuilder subsidies should lead to an increase in economic activity in the residential construction sector, as more consumers demand newly-built homes. Suppliers will expand their supply and demand more labour to build the homes, having a positive effect on the goal of full employment. (2) [Students may also consider the multiplier effects of the initial injection of spending, but this is not necessary for full marks.]

- b. Explain which component of GDP the spending on newly-built homes will be recorded as. 2 marks

Suggested answer

Spending on houses is considered part of the investment (I) component of GDP (1), since it adds to the stock of capital assets of the economy, rather than being consumed. Household spending is usually considered consumption, but spending on a capital asset like a home is considered investment (1).

- c. Outline **two** ways in which the government may fund the increase in spending due to the HomeBuilder scheme. 2 marks

Suggested answer

Governments use taxation and other revenue collected in order to fund outlays such as spending on infrastructure or transfer payments. (1) When the government spends more than it receives (a budget deficit), this can be funded via borrowing, usually through the selling of government securities for which it pays a return on investment to security holders. (1)

- d.** Analyse the extent to which the HomeBuilder scheme can achieve an improvement in living standards for Australians. 6 marks

Suggested answer

Australia experienced its first technical recession in the first half of 2020 since 1991. The HomeBuilder scheme was effective in stimulating aggregate demand and assisted in minimising the extent of the recession and restoring Australia to positive growth in the second half of 2020. Due to the increased economic activity and increased jobs available in the construction sector, there will be further increased consumption and it is likely that the incomes of Australians will rise, which will provide more access to goods and services, or improved material living standards. A reduction in unemployment 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.

However, not all Australians will experience an improvement in living standards if they do not benefit directly from the scheme or the jobs it creates. Additionally, there may be negative effects on the environment from the increased construction if increased building leads to negative effects on the natural environment such as increased air pollution, deforestation and increased waste.

[This question should be marked globally, and responses can include alternative factors/arguments. To be awarded full marks, responses should consider positive and negative effects of the scheme on both material and non-material living standards.]

Question 3 (20 marks)

- a.** Explain **two** factors that could have contributed to an appreciation of the Australian dollar since the middle of 2020. 4 marks

Suggested answer

An increase in demand for Australian exports such as iron ore will lead to an increase in demand for Australian dollars, as Australian dollars will need to be used to pay for such exports, which leads to an increase in the value of the Australian dollar. (2)

An increase in Australia's cash rate, relative to other countries' will attract foreign investors to invest money in Australian financial assets such as securities. This is because the return on investment is higher in Australia compared to other countries. Foreigners require Australian dollars to buy Australian securities so the demand for Australian dollars will increase, leading to an appreciation of the currency. (2)

[Any two factors can be given here, but the effect on the market for Australian dollars and thus the value of the currency must be explained.]

- b.** Explain **two** factors that could enable Australian exports to become more internationally competitive in 2021. 4 marks

Suggested answer

An increase in productivity growth (an increase in the level of output produced per unit of input) relative to that of foreign competitors can lead to Australian exports being able to be produced at a lower cost, thus being more attractive to foreigners, increasing export demand. (2)

A depreciation of the Australian dollar will essentially make Australian products less expensive for foreigners, as they will require less of their currency to exchange in order to purchase Australian products. This makes Australian exports more internationally competitive, increasing export demand. (2)

- c.** Education has been one of Australia’s major exports in recent years. Due to the Covid-19 pandemic and associated border closures, Australian universities have experienced a significant decline in international students enrolled. This is also expected to impact Australia’s levels of skilled migration in the future. Explain the effect of this situation on the following: 8 marks

- (i)** aggregate demand
- (ii)** the business cycle
- (iii)** the balance of payments
- (iv)** aggregate supply

Suggested answer

Export demand is affected due to a decrease in demand for Australian education, but also a decrease in demand for other products, since if international students are not here they are also not spending on other consumption such as tourism, accommodation, etc. Universities and other educational institutions will invest less as they require less capacity with less students. Overall, aggregate demand decreases. (2)

Business cycles are intervals of expansions followed by contractions in economic activity. Lower aggregate demand, as explained above, will influence a contraction in economic activity, causing the business cycle to either move from expansion to contraction, or making an existing contraction even more severe. (2)

Inflows of money from exports (which spending by international students is classified as) will decrease. This has a negative effect on the balance of trade (inflows from exports minus outflows due to imports) which may lead to the balance of trade being negative, or a lower positive result. The current account balance will be a smaller surplus, or a larger deficit. (2)

Skilled and unskilled international workers can add to Australia’s aggregate supply since they are additional labour resources. International students can work part-time whilst studying, and can use their skills gained through education to assist in Australia’s productivity once they graduate. However, the decline in such students in Australia will limit the potential for this all to occur. [2]

[Alternative responses are acceptable, so long as knowledge is shown of the particular concept and how the scenario impacts on it.]

d. Discuss arguments for and against trade liberalisation.

4 marks

Suggested answer

[Alternative arguments may be provided. Students should consider at least two negative effects of trade liberalisation and two positive effects, and these must be explained, not simply listed]

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 the increased transport 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

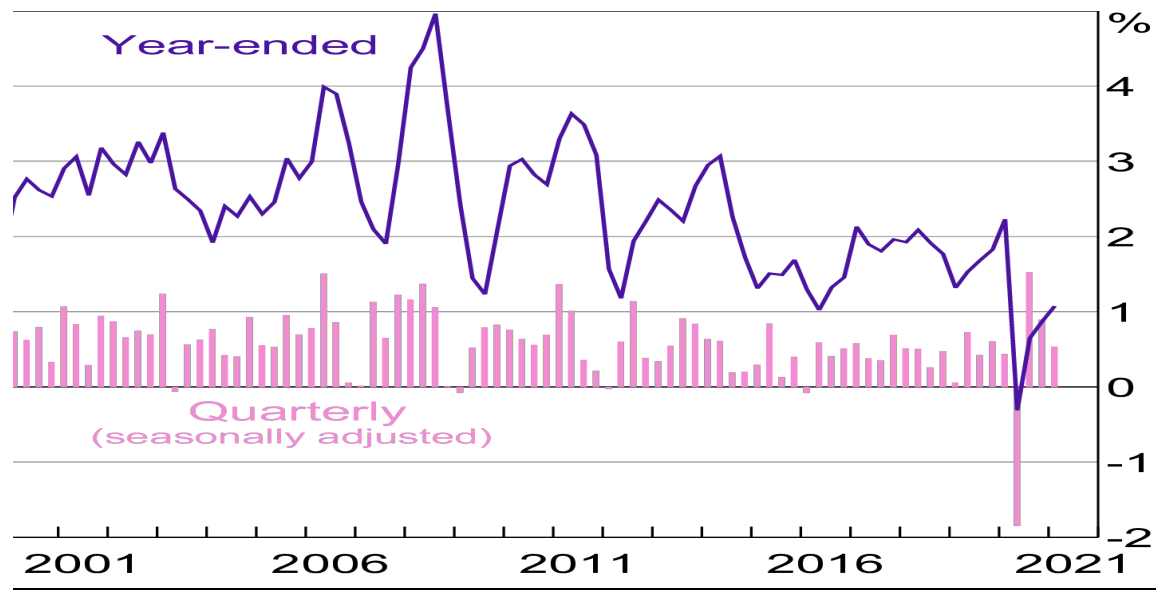
Greater consumer choice

Improved quality of available goods & services

Improved material living standards due to more access to goods and services

Question 4 (15 marks)

Australia’s Consumer Price Inflation



Source: adapted from <https://www.rba.gov.au/chart-pack/aus-inflation.html>

- a. Referring to the graph above, describe the trend in inflation over the past two years. 2 marks

Suggested answer

Annual inflation was between 1 and 2% in 2019 and had just risen to slightly above 2% (1) before a huge decrease in 2020, where we experienced significant deflation for a quarter, before rising again to just above 1% in early 2021 (1).

[Any description that shows adequate understanding of the data is acceptable.]

- b. Explain **two** consequences of a high inflation rate. 4 marks

Suggested answer

High inflation affects income distribution – people with fixed incomes such as pensioners and those on welfare become worse-off since their incomes do not increase as much as the cost of living does. (2) High inflation can have a negative effect on consumer and business confidence, negatively affecting consumption (C) and investment (I) demand. This has a negative effect on aggregate demand, economic growth and employment. (2)

[Any two consequences are acceptable.]

- c. With reference to the Reserve Bank of Australia's (RBA's) charter, explain the reasons for the RBA's monetary policy stance between 2020 and 2021. 3 marks

Suggested answer

The RBA's obligations under the charter are to contribute to the stability of the currency of Australia, maintenance of full employment and economic prosperity and welfare of the people of Australia [1]. Inflation in this time period has been mostly below 1% and was briefly negative (we experienced deflation in one quarter). Inflation has been lower than target inflation of between 2-3% over the course of the business cycle. For this reason, the RBA has implemented and then maintained an expansionary monetary policy [1] to stimulate consumption and investment in an effort to increase aggregate demand to place upward pressure on prices (so as to achieve the goal of bringing inflation within target of 2-3%) but also to contribute towards stronger economic growth and the creation of more jobs. Expansionary monetary policy should have a positive effect on all three of these goals [1].

- d. Discuss strengths and weaknesses of using monetary policy to achieve the goal of price stability. 6 marks

Suggested answer

Monetary policy can be an effective way to achieve the goal of price stability. In times of high inflation, higher interest rates can slow down aggregate demand to bring inflation back within target. Similarly, lower interest rates can effectively stimulate aggregate demand to place upward pressure on inflation when it is below target. There are also multiplier effects, where initial increases or decreases in spending have amplified effects on total spending and therefore prices. Monetary policy has the advantage over budgetary policy in that it is not subject to political bias and is decided on economic factors to determine economic goals, not political goals. The RBA meets regularly to determine monetary policy so it can make changes quickly and easily, leading to dynamic efficiency. However, there is a lag between the decision and the subsequent impact on the economy as households, businesses and foreigners take time to change their economic behaviour in response to the change in interest rates. Also, commercial banks do not always pass on the full extent of interest rate changes to borrowers and savers. The effectiveness of monetary policy depends on households' and businesses' desires to spend (mostly influenced by consumer and business confidence). For example, sometimes lower interest rates do not lead to increased spending if confidence is low, or if, as seen during 2020 lockdowns, households are unable to spend due to business closures and the inability to travel. Further, monetary policy is a blunt instrument so cannot target specific areas of the economy – meaning that if inflation is occurring in one sector, market or geographical area of the economy this cannot be targeted by monetary policy since the cash rate affects all areas equally. Overall, monetary policy can strongly influence inflation through its effects on aggregate demand, but there are limitations in terms of its ability to quickly make an impact, and in terms of it being unable to target certain sectors or areas.

[This question should be marked globally, but responses should aim to show understanding of at least three strengths and three weaknesses]