Suggested answers

SECTION A: MULTIPLE-CHOICE QUESTIONS

Question	Answer	Question	Answer
1	B	**9**	D
2	C	**10**	C
3	A	**11**	A
4	C	**12**	B
5	A	**13**	B
6	B	**14**	D
7	B	**15**	A
8	A		

SECTION B: WRITTEN RESPONSES

***Note**: When making judgements about the quality of student answers to questions, teachers could be guided by some or all of the following factors (depending on the question): accuracy, relevance, completeness, breadth/depth of treatment, logic of connections, clarity, substantiation of claims, level of coherence.*

***Note:** The following are suggested answers only*.

Question 1 (12 marks)

a. Describe the three basic economic questions. 3 marks

Every economy deals with resolving the three basic economic questions when seeking to satisfy the needs and wants of its population. The first question is **what should the economy produce?** The question revolves around the balance of determining what goods and services the economy should allocate its scarce resources to producing.

The second question for the economy to consider is **how should the goods and services be produced?** This relates to consideration of the mix between capital and labour as inputs into the production process.

Finally, the third question asks **for whom should the goods and services be produced?** This question considers the balance between providing goods and services to only those individuals that can afford them and the role of the government in the provision of collective (public and merit) goods and services.

Marking guide:

- ***1 mark (x3)** for each accurate description of the basic economic questions*

b. Explain how the conditions for a free and perfectly competitive market can lead to a more efficient allocation of resources and improved living standards. 6 marks

A free and perfectly competitive market (PCM) is one in which there exists three major conditions; many buyers and sellers, ease of entry and exit and homogeneous goods which each can contribute to a more efficient allocation of resources and living standards, along with minimal government regulations.

Beginning with **many buyers and sellers,** this condition ensures that no individual firm has the ability to exercise market power to place upward pressure on prices or in any way limit supply. This condition contributes to allocative efficiency as businesses need to be responsive to consumer demand, and buyers purchasing power is improved through competition, allowing for improved material living standards.

Ease of entry and exit allows firms to quickly respond to changing consumer preferences. This promotes dynamic efficiency as firms can quickly reallocate scarce resources to produce goods and services with increased demand and therefore satisfying consumer sovereignty and ultimately material living standards.

Finally, a PCM will involve firms selling **homogeneous goods and services**. By selling identical or very similar products, this forces firms to focus on cost minimisation and they must therefore be as productively efficient as possible to maximise their profit margins, as firms will only be able to compete on price. This has the benefit of encouraging the lowest possible prices and therefore contributing to improved material living standards.

Marking guide:

- ***2 marks** for accurately explaining how the condition of many buyers and sellers contributes to allocative efficiency and improved living standards.*
- ***2 marks** for accurately explaining how the condition of ease of entry and exit contributes to dynamic efficiency and improved living standards.*
- ***2 marks** for accurately explaining how the condition of homogeneous goods and services contributes to productive efficiency and improved living standards.*

c. Explain one example of government intervention in markets that unintentionally leads to a decrease in one of allocative, productive, dynamic or intertemporal efficiency. 3 marks

In the Australian market for cigarettes, the government has intervened to discourage their consumption and production through the imposition of an **excise tax**. The excise tax aims to increase the costs of production for cigarette suppliers which in turn diminishes their profitability and discourages production, leading to an increase in equilibrium price and decrease in quantity. Ceteris paribus, intervention leads to a reduction in cigarette consumption which reduces the negative health implications and government resources allocated to dealing with the negative externalities of smoking, all of which leads to an improvement of allocative efficiency.

However, by imposing an excise tax on cigarettes, this could lead to a net reduction in allocative efficiency if consumers seek out cheaper but no less harmful substitutes such as illegal cigarettes, e-cigarettes and illicit drugs. The unintended negative consequences could be further multiplied if government resources are required to be reallocated to the justice system to deal with organised crime associated with illegal cigarettes and illicit drugs.

Marking guide:

- ***1 mark** for describing one example of a relevant type of government intervention*
- ***1 mark** for explaining the unintended negative consequence(s) associated with the government intervention*
- ***1 mark** for explaining how there is a reduction in one of allocative, productive, dynamic or inter-temporal efficiency*

Question 2 (8 marks)

a. Explain two benefits of international trade for Australian living standards.

4 marks

International trade allows businesses in Australia to sell to a larger market. This means that they may be able to benefit from **economies of scale,** which are achieved when a business produces a large volume of goods and services and is able to spread the fixed costs (those costs that will always be close to fixed irrespective of volume) over a larger base. This will mean that the cost per unit of output will tend to decrease, making businesses more profitable and consumers will be able to purchase the products at lower prices and therefore improving material living standards.

Additionally, international trade contributes to **increased competition** among sellers in domestic markets. This forces local firms to both improve the quality of products and offer the lowest possible price in order to remain profitable when competing against overseas suppliers. Again, this can contribute to lower prices and improved quality of goods which leads to improved material living standards.

Marking guide:

- ***1 mark** for identify a relevant benefit of international trade (x2).*
- ***1 mark** for explain how each benefit can lead to an improvement in Australian living standards (x2).*

Month	***A$/USD cents***
Jan 2023	*70.4*
February	*67.3*
March	*67.1*
April	*66.1*
May	*65.0*
June	*66.3*
July	*66.8*
August	*64.9*
September	*64.6*
October	*63.5*
November	*66.5*
December	*68.4*
January 2024	*65.7*

Source: Key Economic and Social Indicators – Parliament of Australia (aph.gov.au) accessed 10/4/24

b. Referring to the table above, describe the trend in Australia's exchange rate and explain how one factor may have contributed to this trend. 4 marks

During the period from January 2023 to January 2024 there has been a depreciation of the A$ relative to the US$ - whereby the Australian dollar when from buying 70.4c US to 65.7c US over that period. The depreciation of the A$ exchange rate may have been caused by the growing **interest rate differential** between the US and Australian economies. If US interest rates were increasing by a larger margin than Australia's interest rates, this would drive a net capital outflow of funds as demand for Australian debt securities would be expected to fall relative to US debt securities. This in turn would lead to a reduction in demand for the A$ relative to the US$, leading to a depreciation of the Australian dollar exchange rate.

Marking guide:

- ***1 mark** for making an accurate reference to the data in the table*
- ***1 mark** for accurately describing a depreciation in the A$ relative to the US$*
- ***1 mark** for describing a relevant factor that could cause a depreciation in the A$/US$*
- ***1 mark** for explaining how the factor causes the A$ to depreciate*

Question 3 (9 marks)

FIGURE 2: AUSTRALIAN BUDGET AGGREGATES

Table 1.2: Budget aggregates

	Actual	Estimates						Projections
	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	Total(a)	2034-35
	$b	$b	$b	$b	$b	$b	$b	
Underlying cash balance	**22.1**	**9.3**	**-28.3**	**-42.8**	**-26.7**	**-24.3**	**-112.8**	
Per cent of GDP	0.9	0.3	-1.0	-1.5	-0.9	-0.8		-0.1
Gross debt(b)	**889.8**	**904.0**	**934.0**	**1,007.0**	**1,064.0**	**1,112.0**		
Per cent of GDP	34.7	33.7	33.9	35.1	35.2	34.9		30.2
Net debt(c)	**491.0**	**499.9**	**552.5**	**615.5**	**660.0**	**697.5**		
Per cent of GDP	19.2	18.6	20.0	21.5	21.8	21.9		18.7

a) Total is equal to the sum of amounts from 2023–24 to 2027–28.
b) Gross debt measures the face value of Government Securities (AGS) on issue.
c) Net debt is the sum of interest-bearing liabilities (which includes AGS on issue measured at market value) less the sum of selected financial assets (cash and deposits, advances paid and investments, loans and placements).

a. Referring to the table above, outline what is meant by the underlying cash balance. 3 marks

The underlying cash balance for the 2024/25 budget is $28.3b and is the most commonly used budget outcome figure when reporting on the annual budget. It is a cash measure that indicates whether the government needs to borrow from financial markets to cover its activities. It is calculated as net cash receipts from operations (excluding future fund earnings) plus financing adjustments plus net cash flows from capital investments.

Marking guide:

- ***1 mark** for making an accurate reference to the table*
- ***2 marks** for an accurate outline of how and what is measured by the underlying cash balance*

b. Describe a discretionary stabiliser from the 2024/25 budget and analyse its role in influencing aggregate demand and the achievement of the domestic macroeconomic goal of low and stable inflation. 6 marks

The 2024/25 budget included one-off $300 energy bill relief for all Australian households and $325 to over 1 million Australian businesses. The government has introduced the measure as a way to ease cost of living pressures for Australian households. This is estimated to cost the budget $3.5b. According to government explanations, the bill relief will be deducted directly from bills prior to them being received by households.

The energy bill relief will effectively place downward pressure on energy prices which is therefore expected to lower consumer price inflation. However, the energy bill relief will effectively increase the disposable income for Australian households (as they will have more money left in their pockets after paying energy bills), leading to an increase in consumption, investment and import expenditure, particularly for households with a high propensity to consume. Ceteris paribus, this would place upward pressure on aggregate demand and create demand inflationary pressures should there be insufficient spare productive capacity in the Australian economy to meet the increased demand.

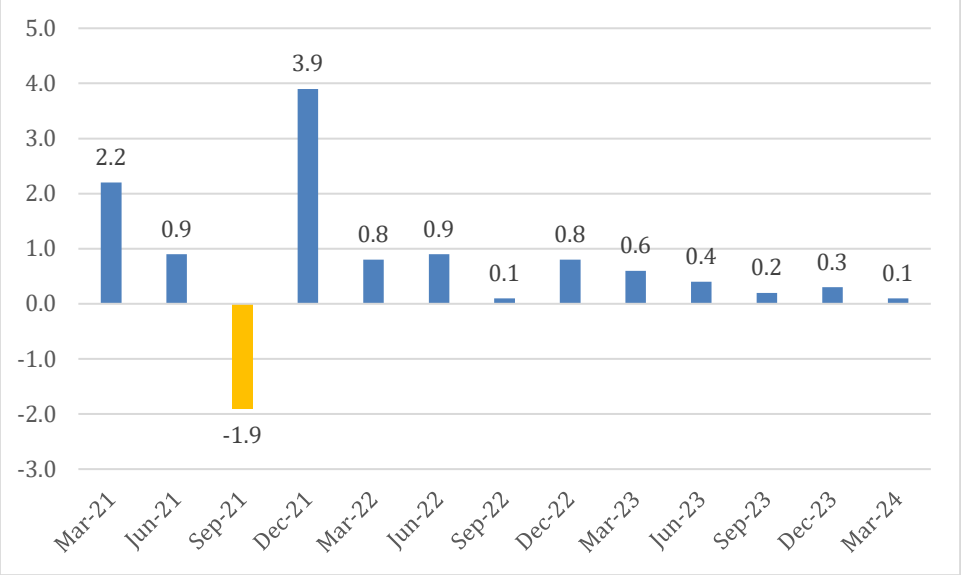
As Australia's March 2024 annual rate of CPI inflation is at 3.6% which is above the top of government's goal of low and stable inflation of 2% to 3% measured by the CPI on average, over time, any additional stimulus to demand inflation will push the inflation rate further away from the achievement of the goal.

Marking guide:

- ***2 marks** for describing a relevant discretionary stabiliser from the 2024/25 budget.*
- ***2 marks** for a detailed analysis of how the discretionary stabiliser is likely to influence aggregate demand.*
- ***2 marks** for a detailed analysis of how the discretionary stabiliser is likely to influence the achievement of the goal of low and stable inflation.*

Question 4 (11 marks)

Quarterly Australian GDP Growth Rates



a. **Referring to the graph above, describe the trend in quarterly GDP for 2023 and calculate the annual rate of economic growth for the year ended 31 December 2023 based on the data provided.** **2 marks**

There has been a decreasing trend in Australia's quarterly GDP as it has slowed from 0.6% in the March quarter 2023 to 0.3% for the December 2023 quarter.

Annual GDP Growth Rate = 0.6% + 0.4% + 0.2% + 0.3% = 1.5%

Marking guide:

- ***1 mark** for describing a slowing rate of quarterly GDP growth rate in 2023*
- ***1 mark** for accurate calculation of Australia's annual GDP growth rate using the data provided*

b. **Explain two aggregate demand factors that may have influenced Australia's rate of economic growth in the past 12 months.** **4 marks.**

One aggregate demand factor that may have influenced Australia's GDP growth rate could have been the falling level of consumer confidence, which can occur when households feel less sure of their present and future financial situation. This was highlighted when the Westpac Melbourne Institute consumer sentiment index remained stubbornly low as it fell from 84.3 to 82.1 points, signifying pessimists far outweighed optimists over the period. As a consequence, low consumer confidence can lead to a reduced consumption expenditure.

Another significant aggregate demand factor influencing economic growth in 2023 was the increase in domestic interest rates. The rise in the RBA's cash rate target from 3.1% in January 2023 to 4.35% by December 2023 put upward pressure on commercial borrowing and saving rates, which therefore encouraged increased saving by households whilst making it more expensive for households and firms to borrow to consume and invest.

Both of these worsening aggregate demand factors had the impact of slowing growth in aggregate demand, leading to rising inventories and therefore slower rates of economic growth as firms slowed rates of production due to weakening demand.

Marking guide:

- ***2 marks (x2)** for logical explanation of each relevant aggregate demand factor linking to components of AD and impact on real GDP*

c. Evaluate the extent to which the Australian economy has achieved the domestic macroeconomic goal of strong and sustainable economic growth in 2023.

5 marks

The Government's domestic macroeconomic goal of strong and sustainable economic growth aims for 'strong' rates of real GDP growth around 3% to 3.5% whilst also being 'sustainable' by not causing unacceptable inflationary, external and environmental pressures.

Australia's annual rate of economic growth slowed in 2023, falling from 2.5% to 1.5% for the year ended 31 December 2023. From a 'strong' perspective it could be argued that the goal was **not** achieved despite record low levels of unemployment. However, from a 'sustainable' perspective it could be argued that relatively slow rates of economic growth, could assist in slowing demand inflationary pressures in the economy as income growth slowed in line with reduced production levels. Additionally, slowing rates of resource depletion are to be expected as reduced rates of production lead to less pressure on the environment as relatively fewer finite resources are used in the production process. Finally, rates of economic growth lower than the rate suggested by the goal mean that the spillover of spending into spending on imports (that lead to a worsening trade balance) is less likely as domestic inflationary pressures ease.

Therefore, it could be concluded that the goal of strong and sustainable economic growth was partially achieved in 2023.

Marking guide:

- ***1 mark** for demonstrating an understanding of the goal of strong and sustainable economic growth*
- ***1 mark** for use of relevant statistics in response*
- ***1 mark** for logical evaluation of how below 3% rates of annual GDP growth suggests the 'strong' element of the goal of strong and sustainable economic growth has not been achieved*
- ***2 marks** for logical evaluation of how slower than target rates of annual GDP growth positively impact on the 'sustainable' element of the goal of strong and sustainable economic growth*

Question 5 (13 marks)

Productivity bulletin: green shoots mark end of productivity bubble
Labour productivity increased for the second quarter in a row in the December 2023 quarter, suggesting a return to 'productivity normal' after the effects of the COVID-19 pandemic. The March Productivity Bulletin finds labour productivity increased by 0.5% in the December quarter, as hours worked fell by 0.3% while output increased by 0.2%. "For two quarters in a row Australians produced more while working fewer hours. And while monthly labour force data is volatile, we can now say with a bit more confidence that the freefall in labour productivity that began in June 2022 has likely bottomed out," said Deputy Chair Alex Robson.

Extract from: Quarterly productivity bulletin – March 2024 - PC productivity insights - Productivity Commission

a. With reference to the extract above, explain how an improvement in the rate of Australia's productivity growth can promote non-inflationary economic growth. 3 marks.

Productivity growth can be described as the situation where there are increased outputs for a given level of inputs. As described above, an increase in labour productivity (Real GDP/hours worked) in the December 2023 quarter suggests that more is being produced for each labour hour. This can have a positive impact on reducing cost inflationary pressures in the Australian economy, which in turn can lead to higher potential rates of economic growth without the creation of unacceptable inflationary pressures.

Marking guide:

- ***1 mark** for demonstrating an understanding of productivity growth*
- ***2 marks** for a logical explanation of how improved productivity growth can lead to non-inflationary economic growth with reference to the quote*

b. Analyse how <u>one</u> of the following aggregate supply policies is designed to positively influence Australia's aggregate supply, international competitiveness and material living standards.

- training and education
- research and development
- subsidies
- infrastructure
- tax reform **5 marks**

The Australian Government has recently undertaken a number of initiatives as part of its 'Future Made in Australia Act'. Included as part of the Act is the creation of the National Reconstruction Fund that is designed to support Australia's manufacturing sector through a combination of loans, guarantees and equity investments that ultimately subsidise the selected industries. If successful, the subsidies will help to reduce the cost of production for specific manufacturing businesses, enabling improved profitability, and willingness and ability to produce, leading to an increase in Australia's aggregate supply.

Additionally, downward pressure on cost inflation and increased domestic manufacturing capability in subsided industries can improve Australia's international competitiveness thereby making it easier for domestic manufacturers to compete on both price and quality in overseas and import competing markets. Furthermore, a growing manufacturing sector is likely to provide employment opportunities for Australians, leading to an increase in both incomes and material living standards.

Marking guide:

- ***2 marks** for outlining the operation of a relevant Australian aggregate supply policy*
- ***2 marks** for analysis of the impact of the aggregate supply policy on aggregate supply and international competitiveness*
- ***1 mark** for explaining the impact on material living standards*

c. Evaluate the short-term and long-term impacts of trade liberalisation on Australia's domestic macroeconomic goal of full employment. 5 marks.

Trade liberalisation involves the reduction and/or removal of government protectionist policies such as tariffs and subsidies that restrict trade between countries. By doing so, domestic firms that are unable to compete in a global market can suffer from loss of sales and even bankruptcy as they struggle to reduce their costs of production in the face of, for example, cheaper imports. This can cause a short-term rise in structural unemployment for those affected individuals, which can conflict with the goal of full employment, being the lowest rate of unemployment (with no cyclical unemployment) that does not fall below the Non-accelerating Inflation Rate of Unemployment or NAIRU. This is said to be the target rate of approximately 4.25% unemployment (or natural unemployment).

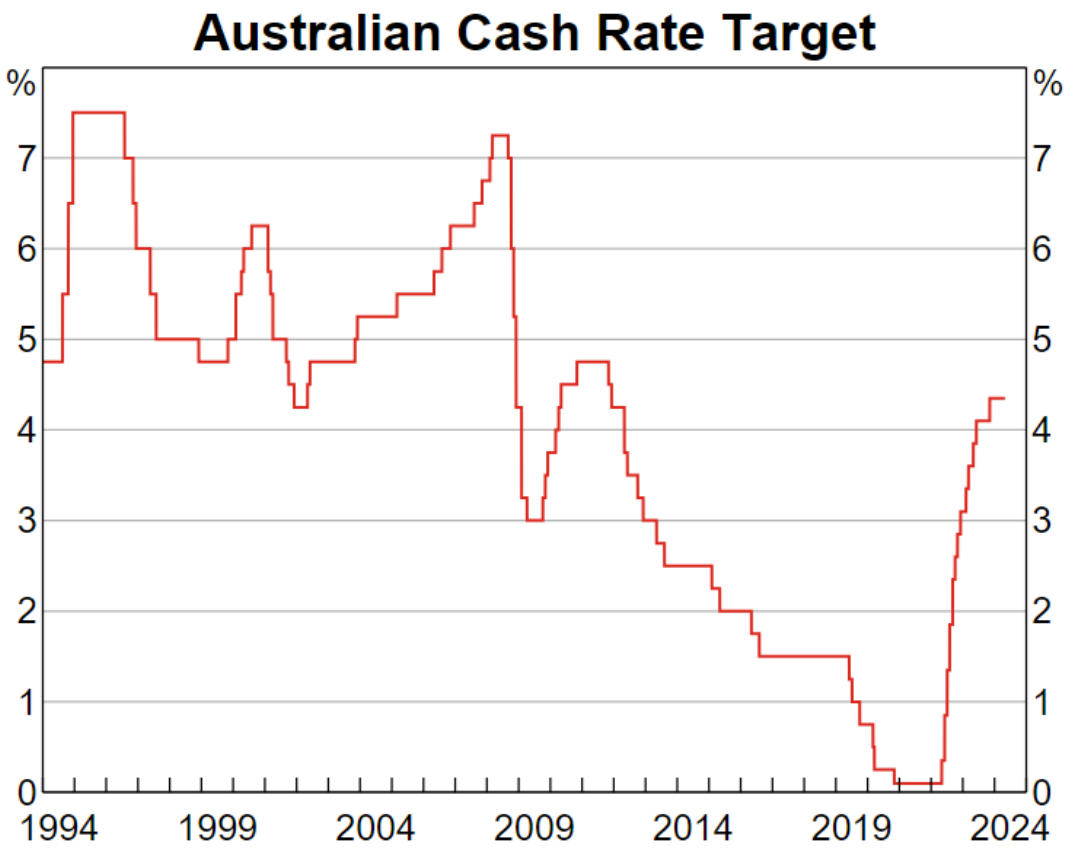
However, in the long term, firms able to compete in a global market (for example by increasing their productivity and modifying their production process to adapt to more rigorous competition) will benefit from additional sales and expand, leading to an increased derived demand for factors of production, including labour. This can lead to downward pressure on the unemployment rate. In this way, in the longer term, the policy of trade liberalisation can be compatible with the achievement of the goal of full employment.

Marking guide:

- ***1 mark** for demonstrating an understanding of trade liberalisation and the goal of full employment*
- ***2 marks** for a logical evaluation of the short-term impacts of trade liberalisation on the goal of full employment*
- ***2 marks** for a logical evaluation of the long-term impacts of trade liberalisation on the goal of full employment*

Question 6 (12 marks)

FIGURE 4: AUSTRALIAN CASH RATE TARGET



Source: RBA.

a. With reference to the chart above and your knowledge of monetary policy, describe the stance of monetary policy in 2024. 3 marks

The RBA's goal of low and stable inflation is to keep inflation (as measured by the consumer price index) at between 2%–3%, on average, over time. During the first quarter of 2024, it was noted that there was a moderation in both headline and underlying inflation to levels closer to the 3% upper limit. In response, the RBA maintained its contractionary stance as demonstrated by no change to its cash rate target of 4.35%, which had been on place since November 2023. This means the stance of monetary policy continues to be contractionary relative to the neutral cash rate target of around 3%. A contractionary stance of monetary policy is where the setting of the cash rate target is such that it will influence interest rates to be at a level that will act to reduce economic activity.

Marking guide:

- ***2 marks** for accurately describing the stance of monetary policy as contractionary with reference to the neutral cash rate target and demonstrating an understanding of a contractionary stance*
- ***1 mark** for accurately referring to statistics from Figure 4*

b. Analyse one strength and one weakness of using monetary policy in positively influencing Australian material living standards. 5 marks

One strength of using monetary policy to influence Australian living standards is its ability to quickly address demand inflationary pressures in the Australian economy. As the RBA Board is now scheduled to meet 8 times in 2024, this means the Board will have eight opportunities to modify monetary policy and to change its cash rate target. This means the RBA has the opportunity to regularly change the cash rate target to address any demand inflationary pressures. When monetary policy is effective in addressing inflationary pressure, it can reduce upward pressure on the CPI which would reduce the purchasing power and therefore the material living standards of the household sector. This makes monetary policy relatively strong in contrast to budgetary policy, which is only revised on an annual basis.

A weakness of monetary policy is that might be relatively ineffective in reducing inflationary pressures in the economy if they are primarily attributable to supply side shocks to the economy. This has been evident in 2023 and 2024, as significant increases in transport, fuel and energy costs over the past year have been a significant cause of inflationary pressures in the Australian economy. This contrasts with budgetary policy, which can be used to target both demand and cost inflationary pressures simultaneously through targeted spending and revenue measures.

Marking guide:

- ***2 marks** for providing a logical advantage or strength of the use of monetary policy to positively impact on living standards*
- ***2 marks** for providing a logical weakness use of monetary policy to positively impact living standards*
- ***1 mark** for logical reference to impact on material living standards for both the advantage and weakness.*

c. Examine two consequences for living standards if the goal of low and stable inflation is not achieved. 4 marks

Should Australia's rate of CPI inflation exceed the Government's target of low and stable inflation of 2% to 3% growth in CPI on average over time, then households can experience a reduction in material living standards due to reduced purchasing power and decreased levels of employment and therefore income over time.

Purchasing power refers to how much can be purchased with a given amount of money. High levels of inflation in Australia (generally CPI inflation greater than 3%) will reduce or erode the purchasing power of households. As the general level of prices rise (higher than any increase in disposable incomes) households can purchase less with a given amount of money. Expressed another way, if household income levels do not change over time, household real income will fall as the inflation rate rises, leading to a fall in the purchasing power of household income.

Additionally, a domestic inflation rate that exceeds the rate of Australia's major trading partners will, ceteris paribus, have negative impacts for the price competitiveness of Australia's tradables sector. For example, due to relatively faster growth in the relative price of tourism and education sector in Australia, it would be expected that demand will decline, leading to a reduction in the derived demand for labour in the tourism sector, leading to reduced incomes and therefore material living standards for impacted households.

Marking guide:

- ***2 marks** (x2) for providing a logical negative consequence for living standards as a consequence of not achieving the goal of low and stable inflation.*

Subject editor: Timmee Grinham

Chief editor: Geoff Peel

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