

- Australian producers are likely to gain more through improved access to overseas markets than Australian consumers gain from access to cheaper imported products (as Australian trade barriers were already low).
- **Non-economic factors**
  - **Political factors:** There are considerable political considerations that affect inter-national trade (e.g. Brexit and Trump's presidency)
  - **Social factors:** Trade impacts of people lives and the communities they live in.
  - **Environmental factors:** Growth involves the use of more resources but also allows the more efficient use of resources.
- **Economic models based on unrealistic assumptions:** Economic models, such as comparative advantage PPF diagrams and consumer surplus and producer surplus diagrams, are used to show the theoretical static gains from trade, but they are based on several unrealistic assumptions e.g. that the products traded are homogenous and that there are no transport costs. In the real world the dynamic gains are often more important than the static gains.

### *Keeping up to date*

Finding up-to-date data about trade agreements is not easy, but [www.dfat.gov.au](http://www.dfat.gov.au) will provide useful trade information.

### *Slideshare and YouTube*

You can download a Slide Presentation about Gains from Trade from [www.slideshare.net/AndrewTibbitt](http://www.slideshare.net/AndrewTibbitt) or YouTube by searching for Andrew Tibbitt, WACE Economics, Year 12 or using the YouTube URL [https://youtu.be/b6x2\\_sYfyzs](https://youtu.be/b6x2_sYfyzs)

## Section A: Multiple Choice Questions

1.

(2012:07)

This question refers to the table below which shows output per unit of input in the production of cars and steel in Australia and China.

Country	Cars	Steel
Australia	6	12
China	2	8

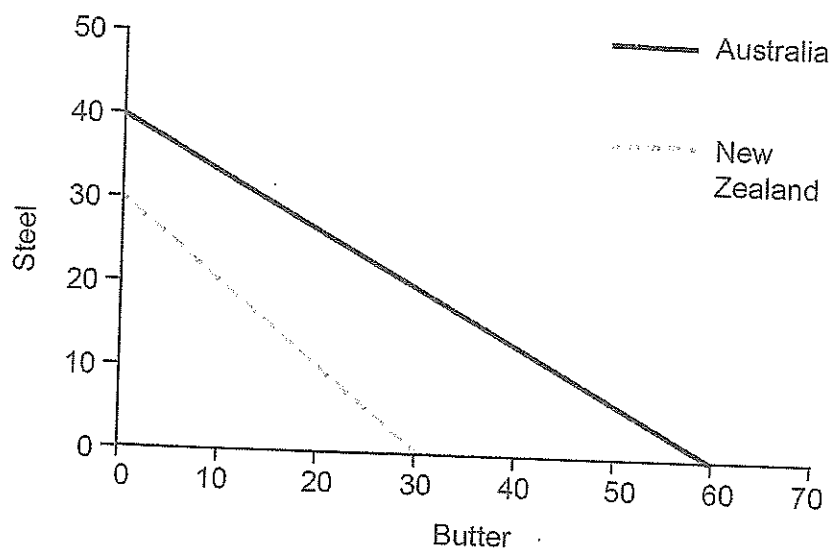
This information indicates that Australia has an

- absolute advantage in both goods and a comparative advantage in neither.
- absolute advantage in both goods and a comparative advantage in steel.
- absolute advantage in both goods and a comparative advantage in cars.
- absolute advantage in neither good and a comparative advantage in cars.

2.

(2013:02)

This question is based on the graph below, which shows the production possibilities in Australia and New Zealand for butter and steel.



Which of the following statements is correct?

- (a) Australia has a comparative advantage in both products.
- (b) New Zealand has a comparative advantage in steel.
- (c) It would be best for Australia to produce both products.
- (d) The opportunity cost of producing 1 unit of butter in Australia is 2 units of steel.

3.

(2013:05)

A potential benefit of trade liberalisation is that it will

- (a) allow countries to specialise in goods in which they have the greatest opportunity cost.
- (b) tend to lead to greater diversity in domestic production.
- (c) reduce the level of the current account deficit in the short term.
- (d) lead to higher living standards for domestic consumers.

4.

(2014:02)

This question refers to the table below which shows the production possibilities in Australia and Japan for two products, cars and rice.

	Cars		Rice
Australia	40	or	50
Japan	60	or	60

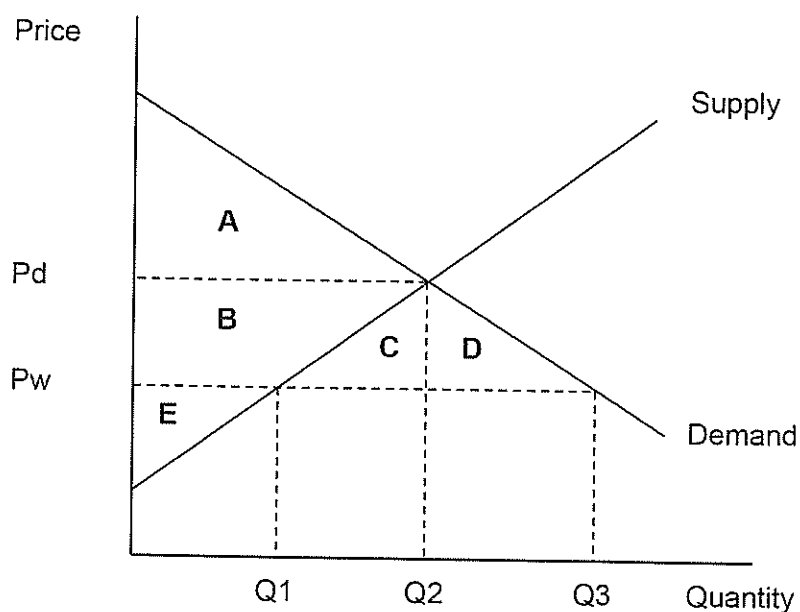
On the basis of this data, which of the following statements is correct?

- (a) Australia has an absolute advantage in producing rice.
- (b) Japan has a comparative advantage in producing rice.
- (c) Specialisation is not beneficial in this case and Japan should produce both products.
- (d) Australia has a comparative advantage in producing rice.

5.

(2014:11)

This question refers to the diagram below that shows the demand and supply for dairy products in Australia ( $P_d$  = domestic price of dairy products,  $P_w$  = world price of dairy products).



On the basis of the information provided in this diagram we can conclude that

- (a) Australia has a comparative advantage in dairy products.
- (b) under free trade the level of imports would be  $Q_2$ .
- (c) the net gain from free trade is represented by the area  $C + D$ .
- (d) there is no net gain from free trade as consumer gains are balanced by domestic producer losses.

9.

(2017:05)

This question refers to the table below, which shows the production of wheat and wool in two countries.

	Wheat		Wool
Country A	650	or	400
Country B	600	or	200

Country B has

- (a) a comparative advantage in wheat production.
- (b) a comparative advantage in wool production.
- (c) an absolute advantage in wool production.
- (d) a comparative advantage in the production of both wheat and wool.

10.

(2017:07)

Which of the following factors contributes to Australia's relatively low trade intensity?

- (a) low transport costs caused by geographical proximity to Asia
- (b) membership of several trading blocs
- (c) a large domestic market with strong competition
- (d) a reliance on primary sector exports

## Section B: Data Interpretation Questions

1.

(2015:27)

Winning over the Xi dynasty (edited extract)  
Laura Tingle

### **China-Australia free trade agreement**

In the wake of the formal announcement this week that a deal had been finalised, there has been much reflection on its ten-year evolution. The story is a complex one reflecting on the rapidly changing nature of Chinese politics and the Chinese economy, changing fashions and developments in multilateral and bilateral trade, and ebbs and flows in the relationship between the two countries.

It also involves a bit of quiet regret by Labor that it did not move faster to get at least one or two of the other free trade agreements – which were eventually signed by the Coalition, with South Korea and Japan – done last year. There seems to be a general consensus across politics that once one of these deals was signed, the others would rapidly follow.

**CONTINUED NEXT PAGE**

6. (2015:06)

This question refers to the table below, which shows the number of labour hours required to produce one unit of a particular product in two countries.

	Surfboards	Skateboards
Country A	6	12
Country B	24	16

In relation to the table above, which of the following statements is correct?

- (a) Country A has a comparative advantage in skateboard making.
- (b) Country A has a comparative advantage in surfboard making.
- (c) Country B only has an absolute advantage in surfboard making.
- (d) Country B has an absolute advantage in both surfboard and skateboard making.

7. (2016:02)

Suppose the production possibilities of Australia and China are as follows:

	Australia	China
Iron ore	3000 tonnes	3500 tonnes
Rice	600 tonnes	2100 tonnes

Which of the following statements is correct?

- (a) Australia has an absolute advantage in producing iron ore.
- (b) Australia has a comparative advantage in producing rice.
- (c) China has a comparative advantage in producing rice.
- (d) Australia has an absolute advantage in producing both commodities.

8. (2017:03)

The international competitiveness of a nation would decline if

- (a) the local currency depreciated.
- (b) the capital to labour ratio rose.
- (c) real unit labour costs rose.
- (d) the local price level fell relative to its trading partners.

- (c) Using an appropriate diagram, explain how free trade agreements can benefit the Australian economy. [6]

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

Diagram



- (b) Use the aggregate expenditure (AE) model to demonstrate and explain the impact of falling investment on real gross domestic product (GDP) in an economy. [4]

Model

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are approximately 20 lines visible, starting from the top margin and ending near the bottom edge. The paper appears to be a standard notebook or legal pad style.



2. [12 marks] (2017:25)

This question refers to the edited extract below, which is from an article Written by Tony Makin and published in *The Australian* on January 12, 2017.

### Post-GFC trade slowdown

One of the puzzles about the performance of the world economy since the 2008–09 global financial crisis has been that the slowdown in international trade has exceeded the slowdown in economic growth.

Globalisation was a driver of pre-GFC global growth, consistent with the theory that international trade was a powerful economic engine fuelled by the productivity gains it generated.

From 1985 to the GFC, world trade grew twice as fast as world gross domestic product whereas global trade grew at less than 2 per cent last year.

According to the International Monetary Fund, the main cause of the trade slowdown since the GFC has been an investment crash in advanced economies.

The weak investment reflects poor productivity in advanced economies, still-damaged European and US banking systems, ongoing budget deficits that crowd out investment funding, the slowdown in Chinese economic growth and global debt that has never been higher.

Meanwhile, restrictive international trade measures imposed by governments worldwide since the GFC account for much of the rest of the slowdown. More than 1200 restrictive trade measures have been implemented by G20 economies since 2008 and continue to increase, currently at the rate of 17 each month according to the WTO.

So promoting freer trade and limiting self-defeating protectionism also remain as important as ever – more globalisation, not less, will improve the world economy.

(a) (i) At what rate did global trade increase by in 2016? [1]

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(ii) Identify **one** reason for the 'investment crash in advanced economies'. [1]

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(iii) What is the role of the World Trade Organisation (WTO)? [1]

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### Section C: Extended Writing Questions

NOTE: Lined pages are provided for each extended answer in the WACE exam paper. At the end of this section you will find planning grids which you can use in the preparation of a good extended writing answer.

1. (2016:28)
  - (a) Discuss the influence of **one** trade organisation and **one** bloc on world trade. [10]
  - (b) Explain **four** arguments for trade liberalisation. Draw an appropriate model to support your explanation. [10]

awareness is arguably a good thing in its own right.

Some negative aspects of globalisation are:

- **Loss of national and economic sovereignty:** The Australian governments may feel less in control of their destiny as result of globalisation. For example, economic performance is more vulnerable to economic shocks in other parts of the world, and international capital and financial flows can destabilize commodity and currency markets. Governments in several countries have been struggling to find ways to make multinational companies, such as Apple, Google and Starbucks, pay tax in countries where their revenue is generated rather than where tax rates are lowest.
- **Structural change:** Changes to the pattern of production associated with globalisation have increased the pace of structural change in developed economies. There has been a reduction in manufacturing jobs in several countries as multinational corporations outsource their production to low wage economies where health, safety and environmental standards are lower.
- **Opportunities for exploitation and greater exposure to market failure:** Globalisation is associated with the spread of environmental damage (caused, for example, by food miles, exploitation and depletion of resources), poor and unsafe working conditions and money laundering.
- **Bad behaviour by multinational corporations:** Multinational corporations (MNCs) have been associated with a number of areas of bad practice such as tax evasion through transfer pricing, repatriating profits rather than reinvesting them in the local economy, and employing foreign workers rather than training local workers. MNCs, with their massive economies of scale, may drive local companies out of business. If it becomes cheaper to operate in another country, the MNC might close down the factory and make local people redundant.

## Chapter 2: Free Trade

### Section A: Multiple Choice Questions

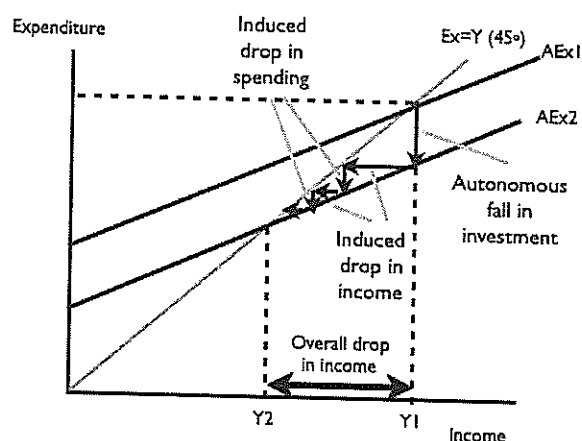
- 1.(2012:07c) In absolute terms Australia produces more of both products than China, but Australia is 3 times as efficient at making cars and only 1.5 times as efficient at making steel.
- 2.(2013:02b) New Zealand experiences a lower opportunity cost than Australia when producing steel.
- 3.(2013:05d) Trade increases welfare and raises living standards.
- 4.(2014:02d) Australia is 83% (50/60) as good as Japan at producing rice, but only 67% as good at producing cars (40/60).

- 5.(2014:11c) Gains in consumer surplus outweigh the loss in producer surplus.
- 6.(2015:06b) Country A makes a surfboard in half the time it takes them to make a skateboard. Country A is more efficient than Country B in both products.
- 7.(2016:02c) China has a bigger advantage in rice production than iron ore production.
- 8.(2017:03c) The cost of production will increase and products will, other things being equal, become less competitive.
- 9.(2017:05a) Country A has an absolute advantage in both products and a comparative advantage in wool. Country B has an absolute disadvantage in both products and a comparative advantage in wheat.
- 10.(2017:07c) The main factors that lead to a relatively low level of trade intensity or openness are (i) an unfavourable location, (ii) substantial geographical area and (iii) large populations. Of the options provided c appears to be the best choice.

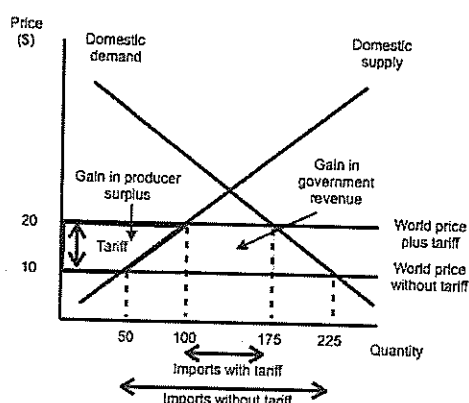
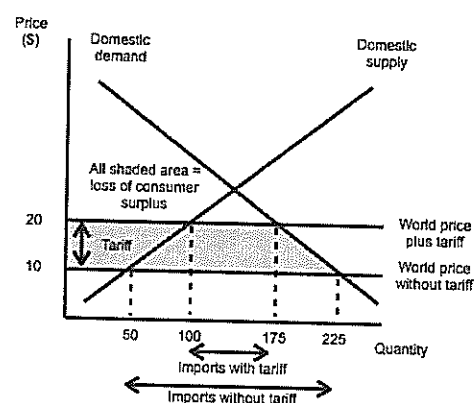
### Section B: Data Interpretation Questions

- 1.(2015:27) (a) 10 years; (b) South Korea and Japan  
  
(b) Tariffs (e.g. 5% import tax on cars), subsidies (financial payments to car producers to produce 'green' cars and quotas (ban in imports of bananas).  
  
(c) Use a consumer surplus diagram to show increase in consumer welfare from access to cheaper world products and a producer surplus diagram to show an increase in producer welfare from access to world markets. Or use the tariff diagram to show the reduction in deadweight loss when the tariff is reduced or eliminated. There are also dynamic gains from extra competition, opportunities for economies of scale and from access to a wider range of products.
- 2.(2017:25) (a) (i) Less than 2%; (ii) Factors mentioned in passage include poor productivity performance (which affects the returns from investment), damaged European and US banking systems (which makes it harder for business to raise investment finance), budget deficits crowding out investment (e.g. because government spending might have replaced spending that would have been done in the private sector), a slowdown in Chinese growth (which, for example, reduces the need for capacity creating investment in mineral and energy sectors) and global debt problems (leading to uncertainty and lower business confidence); (iii) The WTO establishes the rules for international trade (e.g. non-discrimination of tariffs), polices their rules and arbitrates on trade disputes and encourages a reduction in the overall level of tariffs.  
  
(b) When aggregate expenditure is at AEX1 equilibrium income is at level Y1. With the fall in planned investment AEX1 falls to AEX2. The economy is no longer in equilibrium because planned expenditure is less than income. The fall

in investment leads to a multiplier process that eventually reduces income to Y2. At income Y2 income equals planned expenditure and the economy has reached a new equilibrium level. The fall in income is greater than the change in investment that brought it about. (Note: You wouldn't be required to show the step by step process of the multiplier but put it in if you have time).



(c) Total welfare or community surplus is an indicator of market efficiency. The tariff diagram shows that total welfare is reduced (and deadweight loss rises) when a tariff or import tax is levied on a product.



In the diagrams above, the 'world price without tariff' line indicates the price of imports when trade is tariff free (i.e. \$10). The 'world price plus tariff' line shows the price of imports when a \$10 tariff is levied (i.e. \$20). The level of imports drops

from 175 to 75. The loss of consumer surplus is shown in the top diagram, while the gain in producer surplus and gain in government revenue is shown in the bottom diagram. The overall result is a welfare loss shown by the two white triangles in the bottom diagram.

This model can be used to show the impact of other protectionist measures such as quotas or subsidies. Other models, such as production possibility models, and calculations of output levels when there is reduced specialisation and less exploitation of comparative advantage could also be used.

### Section C: Extended Writing Questions

- 1.(2016:28) (a) The World Trade Organisation (WTO) started life as the General Agreement on Tariffs and Trade soon after the end of the Second World War. The WTO has contributed significantly to the growth of world trade. For example following China's membership of the WTO in December 2001 trade volumes jumped and China became the number one trading partner of many countries, including Australia. The WTO has 164 member nations and influences world trade in three ways.

First, it promotes trade liberalisation through a series of rounds or negotiations. Early rounds were successful in achieving widespread tariff reduction on goods but since 2000 the WTO has not been able to make much progress on liberalising trade services and dealing with issues of intellectual property. It has also found it difficult to control non-tariff barriers to trade.

Second, the WTO has established a series of rules covering international trade between its members. An important rule is the most-favoured nation principle that outlaws tariff discrimination between trading partners (i.e. Australia can't have one tariff for Japan and a different tariff for Korea unless there is a special trade agreement for this). The WTO also allows anti-dumping tariffs.

Third, the WTO rules over trade disputes, e.g. between New Zealand and Australia over the export of apples.

At a regional level, Australia trades within AANZFTA, a trading bloc comprising the Association of South-East Asian Nations, Australia and New Zealand that came into force in 2010. Trading blocs are sanctioned by the WTO even though they ignore the most-favoured nation principle. AANZFTA led to extensive tariff reductions, new regional rules of origin that made it easier for Australian business to join international supply chains, legal protections for foreign investment and the establishment of a forum to promote further economic cooperation between the members. While tariff reductions between members create additional trade flows between members they might cause some trade to be diverted away from non-members.

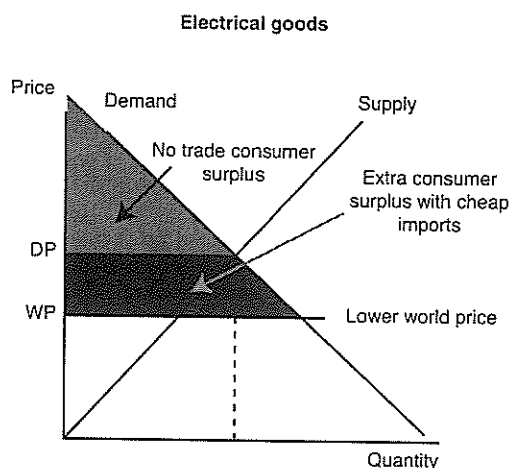
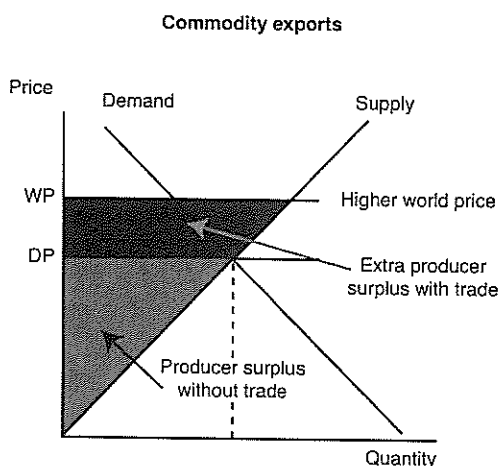
(Note there are other organisations (e.g. G20, APEC) and trading blocs (EU, NAFTA, and bilateral trade agreements) that could be the focus

of the answer to this question. Points common to all answers would be growth of trade, change in the direction and composition of trade, regional agreements being more successful than global agreements, trade diversion, countries by-passing the rules by dumping and use of non-tariff trade barriers.)

(b) The world is full of examples of societies that have flourished as a result of trade. Economies benefit from:

- **Static gains:** Trade generates a more efficient use of resources, with the production of goods and services taking place in countries where opportunity costs are lowest. Local producers have greater access to export markets and consumers have greater access to cheaper imports.
- **Dynamic gains:** Trade generates further efficiencies from, for example, increased competition that promotes 'behind the border' economic reform, economies of scale, networking gains and knowledge transfers, reduced border administration and improved international relations and understanding.

The gains of trade can be illustrated using a number of models. For example, the diagrams below show that as a result of specialisation in areas of relative efficiency, Australian commodity producers can earn higher levels of producer surplus with access to overseas markets and Australian consumers can enjoy higher levels of consumer surplus as a result of access to cheap imported goods.



As a result of trade liberalisation overall material living standards have improved, poverty has been reduced, and life expectancy has increased around the world. Emerging and developing economies have been the prime beneficiaries of economic openness. According to the World Bank, trade has helped reduce by half the proportion of the global population living in extreme poverty between 1990–2010. China, for instance, saw a phenomenal drop in its extreme poverty rate from 36% at the end of the 1990s to 6% in 2011. In advanced economies economic integration has also lifted living standards through a more efficient allocation of capital, increases in productivity and lower prices for consumers.

## Chapter 3: Protectionism

### Section A: Multiple Choice Questions

- 1.(2012:03c) The World Trade Organisation (WTO) allows anti-dumping tariffs. Protection of some strategic industries could be justified (answer 'a') but answer 'c' is the strongest.
- 2.(2012:04d) Increased tariff protection allows Australian car producers to be competitive within Australia but does not increase competitiveness overseas. A cut in the cash rate (answer 'b') may encourage investment that, in turn, might introduce new technology and promote competitiveness. It may also reduce the value of the AUD.
- 3.(2013:04d) The level of domestic production will increase to  $Q_2$ .
- 4.(2014:03c) Australian firms making products that compete with imported products would struggle to survive.
- 5.(2014:12c) Subsidies help producers by reducing their overall production costs but they are a drain on government finances.
- 6.(2016:05c) Infant industries are growth industries that have the potential to become competitive in the future.
- 7.(2016:10b) Producer surplus increases as the domestic supply curve shifts down and to the right. If the world supply is assumed to be perfectly elastic there is no impact on domestic consumer surplus. Subsidies impose costs on the government and hence taxpayers which offsets gains in producer surplus.
- 8.(2017:06a) Trade liberalisation leads to structural change and structural unemployment.

### Section B: Data Interpretation Questions

- 1.(2014:26) (a) (i) There is an inverse relationship between protectionism and competitiveness. According to the extract 'car makers only produced world-class cars when protectionism was stripped away'.
- (ii) Structural change caused by the growth in the mining sector and the appreciation of the exchange rate value of the AUD.