

**Economics Unit 1 Exam Semester 1 2021**

**Marking Guide**

**Section 1 (24 marks)**

1 A

2 D

3 A

4 C

5 C

6 A

7 A

8 B

9 D

10 C

11 D

12 D

13 C

14 A

15 A

16 B

17 C

18 B

19 A

20 D

21 A

22 B

23 B

24 C

**Section 2 (36 marks)**

**Question 25 (12 marks)**

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| (a)  **Demand**: identification of one factor  Chinese construction boom, increased steel demand from EU and US, emerging markets demanding more steel and therefore iron ore  **Supply**: identification of one factor  Exports from Brazil have collapsed | 1 mark  1 mark |
| (b) Supply of iron ore is likely to be price inelastic.  This is due to the **nature of the industry**. It takes time to expand existing mines or build new mine sites assuming known deposits are used. Further exploration for new mines would take even further time.  *Students may place an emphasis on* ***Time*** *– this is also acceptable.* | 1 mark  1 mark |
| (c) There has been an increase in demand (rightward shift of the demand curve) from growing economies.  There has been a decrease in supply (leftward shift of the supply curve) due to the Brazil mining disaster.  Diagram:  Large rise in price as reflected in the article. The change in quantity will be dependent on the relative size of the demand and supply changes.  Axis labelled and change in equilibrium price shown. | 1 mark  1 mark  2 marks |
| (d) Evidence can be all or part of this paragraph:  “Higher prices encourage production, which increases appetite for investment. If this happens, then it should offset the supply shortages. Many new iron ore projects are in the pipeline or already underway.”  The increase in supply from investment and new projects will contribute to a moderation of price rises in the longer term (depending on relative change in supply)  Correct diagram showing increase in supply (rightward shift in the supply curve) and therefore a fall in prices and greater market quantity.  *Students may include the increase in demand from previous diagram so the result may be a smaller rise or movement back towards initial price.* | 1 mark  1 mark  2 marks |

**Question 26 (12 marks)**

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| a. i. 10 x 0.82 = 8.2% | 1 mark |
| b. ii. 5.4 / 10 = 0.54 | 1 mark |
| c. iii. Beer and wine are **substitutes** because the cross-elasticity is **positive.** | 1 mark |
| b.  Explanation:  As incomes rise, the quantity demanded of wine will increase more than that of beer.  Reason for difference:  Wine is likely to be more of a discretionary expense and seen more as a ‘luxury’ item compared to beer. | 1 mark  1 mark |
| c. Diagram: 3 marks Explanation: 3 marks  Correct identification of the initial equilibrium price and quantity and the new equilibrium price (higher) and quantity (lower).  Correctly shaded area representing government revenue.  The PED of beer is 0.84. This means it is relatively price inelastic. The gradient of the Demand curve is also steep.  *See p.67 Parry and kemp 6th Edition*  The PED of beer is 0.84. This means it is relatively price inelastic.  As a result most of the tax is passed onto consumers as a price rise (incidence of the tax).  The quantity demanded in the market does not fall by a significant amount due to the inelastic response and producers only have to pay a small amount of the tax.  Total government revenue represented by the new quantity times the size of the tax (rectangle) – this is high due to inelastic nature of demand. | 1 mark  1 mark  1 mark  1 mark  1 mark  1 mark |

**Question 27 (12 marks)**

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| a. i. Vertical equity: ‘a welfare system that reduces poverty’  ii. Horizontal equity: ‘universal education’ | 1 mark  1 mark |
| b. A welfare system will tax higher earning individuals and transfer this money in the form of welfare payments to those who receive little or no income. This promotes equity by reducing income inequality.  However, some workers may be discouraged from earning more income because of higher tax rates and those receiving welfare benefits may have no incentive to earn a higher income. This will reduce economic efficiency. | 1 mark  1 mark |
| c.  A subsidy is a grant paid to producers to reduce their costs and increase output.  Consumers benefit because they pay less and consume more  Producers benefit because they receive a higher price and sell a greater quantity.  However the cost of the subsidy paid by the government will be greater than the benefits to the consumers and producers. The subsidy is economically inefficient. | 1 mark  1 mark  1 mark |
| d. Diagram: 2 marks Explanation: 3 marks  Labelled diagram with correct identification of the price floor above equilibrium.  Correct identification of the deadweight loss area.  *See p.91 Parry and kemp 6th Edition*  A price floor is a minimum price that is set above the equilibrium price and is designed to benefit the producers.  The result will be a surplus because the quantity sellers wish to sell is greater than the quantity buyers are willing to purchase.  The market quantity is less than optimal and the price is higher than optimal. There is deadweight loss created in the market so it is inefficient. | 1 mark  1 mark  1 mark  1 mark  1 mark |

**SECTION 3 (40 marks) – Answer TWO questions**

**Question 28** **(20 marks)**

(a) Explain, with the use of examples, the non-price factors that can affect the level of demand and supply in a market. (10 marks)

(b) Use a demand/supply model to demonstrate and explain why a market operating at equilibrium is efficient. Use the concepts of consumer surplus and producer surplus in your answer.

(10 marks)

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| (a) 2 marks per non-price factor (maximum of 6 marks for Demand and 4 marks for supply).  For each non-price factor: 1 mark for description of factor and 1 mark for example/elaboration  **Non-price factors affecting demand:**  Level of disposable income (distinguish between normal and inferior goods)  The price of related goods (distinguish between substitutes and complements)  Tastes and preferences (role of technology, advertising etc.)  Expectations of consumers (future expectations determine whether purchases are brought forward or delayed)  Demographic factors (size and age composition and changing demand for goods and services)  **Non-price factors affecting supply:**  Costs of production (changes in costs of labour, capital and raw materials will increase or decrease supply)  Technology (technology improves productivity/efficiency increasing supply)  Prices of other goods (producers will shift production priorities towards goods/services that have higher profit margins)  Number of sellers (markets earning profits will have new sellers entering the market and increasing supply)  Expectations of producers (higher prices in the future will encourage investment to increase production in the future or current supply is withheld due to lower prices) | 1-6 marks  1-4 marks |
| (b) Explanation: 7 marks  A market is efficient if it produces the goods society wants at the lowest possible cost.  Price is the measure of the benefit to the consumers and the cost to producers. Price matches the demand of consumers and the supply of producers. The competitive market establishes an equilibrium price and quantity when demand equals supply  Consumer surplus is the difference between what a consumer is prepared to pay and what they actually pay (the difference between total benefits and expenditure).  Producer surplus is the difference between what a producer is willing to receive (their cost of production) and what they actually receive (the difference between total revenue and the cost of production).  Total surplus is a measure of the net benefits to society from both production and consumption of a good. It is the sum of CS and PS. It is also a measure of economic efficiency and this is only **maximised at equilibrium** – this is where we have the most efficient allocation of resources. Under or over production will create a deadweight loss and reduce total surplus.  Model: 3 marks  Correctly labelled diagram with equilibrium price and quantity identified and CS and PS correctly identified | 1 mark  1-2 marks  1 mark  1 mark  1-2 marks  3 marks |

**Question 29** **(20 marks)**

(a) Distinguish, with the use of examples, between public goods, common resources and negative externalities and explain why they are associated with market failure. (12 marks)

(b) Discuss the policy options available to the government to deal with the market failure associated with public goods, common resources, and negative externalities. (8 marks)

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| (a) 3 x 4 marks  **Public good:**  non-rival – everyone can consume the good/service at the same time  non-excludable – Non-payers or free-riders cannot be excluded  Examples – lighthouses, suburban roads, national defence, national parks, free to air television and public broadcast radio  The market fails because private producers will not provide these goods as they cannot be priced and sold in a market. They will not generate a profit as free riders can enjoy consumption without payment to cover the cost of provision.  **Common resource:**  Non-excludable – anybody can access these goods and they have no price  Rival – consumption by one person affects the consumption of others.  Examples – natural resources such as fish stocks, the atmosphere, and roads that become congested during peak times  The market fails because the common resources are over-consumed as individuals use rational self-interest to consume as much of the free good as possible. The result is a rapid depletion of common resources – this is called the ‘tragedy of the commons’.  **Negative Externalities:**  Side effect of economic activity that has a cost on a third party and this cost is not included in the market.  Examples – air pollution from driving cars and flying on planes, using fossil fuels causing global warming, pollution affecting the health of local residents.  The failure to internalise the external cost means production will be greater than the optimal amount and the market price will be less than the optimal price.  If producers were forced to pay for the external costs, then there would be no externality and no market failure. | 1 – 4 marks  1 - 4 marks  1 – 4 marks |

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| (b) 3 x 2 marks + 1 x 2 marks  **Public good policy options:**  Many public goods are important for society and if the private market does not provide them, then the government must supply these goods and services and cover their cost from general taxation.  For example, the local government provides footpaths and local parks, the State government provides roads and Police, the Commonwealth government provides national defence forces, national parks and funds the ABC.  The exception to government provision is free-to air television and public radio broadcasting. They are both non-rival and non-excludable but private firms provide most TV channels and radio stations. This is because they generate income by charging for advertising. The government still provides some TV and radio services such as the4 ABC.  State governments also provide publicly funded schools and hospitals because if these services were left to the private market they would be too expensive for many families (even private schools that charge fees are still heavily subsidised by the government). The government provides these ‘merit goods’ because they have a large positive external benefit for the society.  **Common resources policy options:**  The government must act as protector and regulator of common resources to ensure they are not over-consumed. There is no automatic incentive for individuals and private firms to limit their use of natural environmental resources when they are seeking to maximise their self-interest and/or profits.  For example, restrictions can be placed on the fishing season, bag limits for recreational fishing and fishing license quotas. This will ensure that fish stocks are sustainably harvested.  Tolls can be placed on the use of freeways especially at peak times to reduce congestion. Legislation can be passed regulating the amount of carbon emissions released into the atmosphere.  **Negative Externality:**  Government should take action to reduce the production of goods causing negative externalities.  The external cost can be internalised by the government placing a tax (equal to the external cost) on production of the good.  The tax forces the polluter to pay and decreases supply causing an increase in price and a decrease in quantity produced (reward diagram if provided – *as per p.115 Parry and Kemp 6th Edition)* | 1-3 marks  1 – 2 marks  1 – 3 marks |

**Question 30** **(20 marks)**

1. Describe, with the use of some Australian examples, the features of markets characterised by imperfect competition. (8 marks)
2. Outline **two** types of anti-competitive behaviours used by firms and demonstrate with a model how significant market power can influence market efficiency. (8 marks)
3. Discuss the role of government and the Australian Competition and Consumer Commission (ACCC) in ensuring greater market efficiency. (4 marks)

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| (a)  Imperfect markets:  There are a **small number of firms in the market** reducing competition. This is often due to **restrictions on entry to market**. This can be due to government regulation (government monopoly such as Australia Post), patents, technology barriers, start-up costs such as capital requirement, economics of scale, licensing requirements, brand proliferation.  **Firms with market power** can become price setters. This means firms can, to some extent influence the prices they charge as they have **differentiated their products** with use of adverting and building brand loyalty.  The result of an imperfect market will be a tendency for firms to exploit the market as they seek to maximise profits. The variations in either price or output will maximise their private interest but overall economic welfare of the society will be lower than for a competitive market.  Non-competitive market examples:  Electricity Market in WA (Synergy – monopoly)  Postal service market (Australia Post - monopoly)  Grocery market (Coles and Woolworths dominant – duopoly), Mobile phone market (Telstra, Optus and Vodafone dominant – oligopoly) | 1 – 5 marks   1. 3 marks |

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| (b) Outline of two: 2 x 2 Demonstration and explanation: 4  Anti-competitive behaviour refers to any agreements or arrangements between firms that seek to restrain competition and thereby remove the automatic regulation that comes from competitive markets.  Examples of business practices that reduce competition include:  Cartel  Collusion  Market sharing  Collusive Tendering  Predatory pricing  Resale Price Maintenance  Exclusive Dealing  Collective Boycotts  Mergers  *(see definitions on p. 109-110 Parry and Kemp 6th Edition)*  Diagram and explanation of Market Power:  Correctly labelled diagram showing:  Increase in price set by firm above equilibrium price.  Reduction in Q from equilibrium  Result is increase in producer surplus but this does not outweigh the reduction in consumer surplus  creation of deadweight loss in the market | 1 - 4 marks  1 mark  1 mark  1 mark  1 mark |

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| (c)  Government regulation/deregulation:  Government can use regulation/deregulation to influence market power. Some markets may be regulated because of the nature of the good or service. E.g. firearms. Some markets may have been regulated to provide a benefit to the supplier – an example was the taxi market where a restriction on the quantity of taxis maintained a higher market price for taxi fares.  Government legislation and the ACCC:  The government can also influence market power through legislation. The main government Act is the Australian Competition and Consumer Act 2010 and contains rules against anti-competitive behaviour. The Act also contains consumer protections laws.  The Act provides for significant financial penalties for firms that engage in anti-competitive behaviour.  The Australian Competition and Consumer Commission (ACCC) administers the Act. Their role is to promote competition in Australian markets, improve the efficiency of the economy, and therefore increase the welfare of the Australian society. | 1 – 2 marks  1 - 2 marks |