

**Economics Unit 1 and Unit 2 Examination, Semester 2 2021**

**Marking Guide**

**Section 1 (24 marks)**

1 D

2 D

3 C

4 B

5 C

6 A

7 D

8 B

9 C

10 C

11 D

12 A

13 B

14 A

15 D

16 B

17 C

18 A

19 A

20 B

21 B

22 C

23 D

24 A

**Section 2 (36 marks)**

**Question 25 (12 marks)**

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| (a)  Correctly drawn demand and supply curves  Correctly labelled curves and axes | 1 mark  1 mark |
| (b)  $150, 50 units | 1 mark |
| (c)  Qd = 20, Qs = 80. There is a surplus of 60  To clear the surplus demand will expand and supply will contract until equilibrium is reached at a lower price | 1 mark  1 mark |
| (d)  Shift of the demand curve to the right, greater shift to the right of the supply curve resulting in a lower price. Drawn and identified on the graph.  An increase in demand means a shift to the right of the demand curve (non-price factor such as consumer preference). In order for the price to fall, the supply of jeans has to increase non-price factor such as technology or cost of production) by a greater amount than the increase in demand. | 1 mark  2 marks |
| (e)  Using point method:  $50-$75 = Ed of 0.22  $75-$100 = Ed of 0.375  $200-$225 = Ed of 2.7  $225-$250 = Ed of 4.5  Students should use at least two calculations to show change along the price range  Jeans become more price elastic as price rises. | 1 mark  (use of appropriate formula)  2 marks  1 mark |

**Question 26 (12 marks)**

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| (a)  Leading: share prices, consumer confidence  Coincident: retail sales, GDP  Lagging: employment, inflation | 1 mark  1 mark  1 mark |
| (b)  Downturn – growth will slow due to the impact of new lockdowns.  Evidence form article:  Any chance of the RBA rising interest rates in the short term have gone. Article suggests support from low rates will be needed until 2024.  Lockdowns ‘will have a heavy impact on the national economy’  ‘lockdowns likely to drive GDP down in the September quarter’  Consumer confidence in Sydney suffering a sharp drop  ‘Retail sales crashed’ | 1 mark  2 marks |
| (c)  Interest rates   * Cost of credit and reward for saving for consumers. Lower interest rates will encourage consumption as interest payments are smaller and the opportunity cost of expenditure using credit falls. Reward for saving also falls. Opposite effect for a higher rates. * Investment often requires borrowed funds. Inverse relationship between interest rates and investment levels. When rates rise, repayments for capital purchased using borrowed funds also rise, along with the opportunity cost of using funds to pay for borrowing costs.   Expectations   * Consumer expectations will have a significant impact on discretionary spending (such as durable items and holidays). Negative expectations about employment and income levels will see reduced spending and the opposite for positive expectations. * Business expectations depend on profit levels, sales inquiries etc. Positive expectations will increase investment and negative expectations will reduce spending on capital, as it will not be needed to produce more goods/services. | 3 marks  3 marks |

**Question 27 (12 marks)**

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| (a)  i. AUD $24.8 billion  ii. 2019  iii. Strong commodity prices | 1 mark  1 mark  1 mark |
| (b)  Goods exports: Iron Ore, LNG, Coal  Services exports: Tourism, education | 1 mark  1 mark |
| (c)  Australia’s main export partner is China followed Japan and South Korea. China and the US are out two main import partners.  China dominates our trade. Its rapidly growing economy requires commodities such as iron ore for steel production.  This growth and higher commodity prices underpin the current account surplus. | 1 mark  1 mark  1 mark |
| (d)  Australia receives foreign investment mostly the form of loans and the purchasing of shares in Australian companies. Australia has traditionally relied on overseas capital for investment needs.  This foreign investment is recorded as a credit in the financial account.  However, the cost of the foreign investment in the forms of interest payments and dividends is recorded in the income category of the current account.  Therefore, an increased surplus in the financial account is reflected in an increased deficit in the current account (unless compensated for by goods and services credits). | 1 mark  1 mark  1 mark  1 mark |

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

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

(a) Demonstrate and explain why competitive markets are the most efficient way to maximise the benefits to both consumers and producers as market participants. (10 marks)

(b) Discuss the concept and determinants of price elasticity of supply. (10 marks)

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| (a)  **Explanation**  Demand curve as marginal benefit curve.  Consumer surplus is the difference between what consumers are willing to pay (MB) and the market price.  Supply curve as marginal cost curve.  Producer surplus is the difference between what producers are willing to receive (MC) and the market price.  Total surplus measures the net benefits from consumption and production. It is the sum of CS and PS.  Total surplus is only maximised at equilibrium in competitive markets where demand equals supply. Non-competitive markets will under-produce or over-produce. As a result, they will suffer from deadweight loss. A deadweight loss is an avoidable decrease in total surplus because the market has been prevented from producing optimal output  As long as market demand and supply reflects all benefits and costs (and this will only occur in a competitive market) then the equilibrium price will maximise CS, PS and TS.  **Diagram**  Correctly labelled demand and supply diagram showing PS and CS correctly and market equilibrium.  Some students may also draw under and over production to prove their argument in relation to competitive markets – reward as appropriate. | 1 mark  1 mark  1 mark  1-3 marks  1 mark  1-3 marks |
| (b)  Price Elasticity of Supply measures the responsiveness of quantity supplied to a change in price. Producers are more responsive in their supply to a price change when supply is price elastic (coefficient greater than 1). An inelastic supply response (coefficient less than 1) means producers are less responsive in their supply to a price change.  Reward use of diagram showing supply curves with different gradients.  Determinants   * Time – in the short run, producers may struggle to immediately increase supply is prices rise (inelastic). However over time, they may be able to manufacture or grow/discover more stock. * Nature of Industry – agricultural products take time to produce, manufactured goods can often be supplied quickly * Ability to store inventories – available stocks held in warehouses can be brought to market quickly. Perishable goods are more inelastic because they cannot be stored for longer periods. | 1-4 marks  2 marks each  (total of 6 – reward the use of examples) |

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

Demonstrate and explain, using the concepts of consumer and producer surplus, the effect of the following government policies:

* Price ceilings and price floors
* A sales tax on an inelastic good
* Subsidy payments to an industry

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| Price ceilings (4 marks)   * Max price set below market equilibrium price. * Aim is to lower prices for consumers * Shortage is created because Qd exceeds Qs. * CS may increase but PS decreases by more creating deadweight loss. * Diagram (P&K p.90)   Price floors (4 marks)   * Min price set above market equilibrium price. * Higher prices raise income for producers * Surplus is created because Qs exceeds Qd. * PS may increase but CS decreases by more creating deadweight loss. * Diagram (P&K p.91)   Sales tax on an inelastic good (6 marks)   * Tax shifts supply curve up by the amount of the tax * Market price rises and quantity falls * Inelastic supply curve means most of the burden of the tax is passed onto consumers in the form of the higher price * CS decreases because consumers pay more and receive less * PS decreases because they receive a lower price and sell less * The Government receives tax revenue but this less than the loss of both CS and PS * The tax creates a deadweight loss. * Diagram (P&K p.93)   Subsidy Payment to an Industry (6 marks)   * Subsidy is a grant to producers so it shifts the supply curve down by the size of the subsidy * The market price falls and the quantity rises * CS increases because they pay less and receive more * PS increases because they receive a higher price and sell a larger quantity * The subsidy cost borne by the Government is greater than the increased PS and CS * The subsidy creates a deadweight loss * Diagram (P&K, p. 94) | Explanation  1-2 marks  Diagram  1-2 marks  Explanation  1-2 marks  Diagram  1-2 marks  Explanation  1-3 marks  Diagram  1-3 marks  Explanation  1-3 marks  Diagram  1-3 marks |

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

(a) Explain how a significant increase in the level of economic activity is likely to impact different types of inflation and unemployment. (10 marks)

(b) Discuss the output and redistribution effects of inflation and unemployment. (10 marks)

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| (a)  Demand-pull inflation   * ‘Too much money chasing too few goods’ * High level of demand in a boom and as production bottlenecks build up, shortages will result in higher prices * Demand for resources such as labour will also cause price rises in final goods and services * Excess money supply compared to output growth   Cost-push inflation   * Rising input costs are passed onto consumers in the form of higher prices for final goods and services * Examples include wage rises due to labour shortages in a boom and oil/petrol prices rising due to rising demand factors.   Cyclical unemployment   * Demand-deficient unemployment. * Higher demand in business cycle upswings/booms means firms hire workers * Markets involving discretionary spending/non-essential services will increase employment levels.   Structural unemployment   * Mismatch of available and required skills * Likely to increase in times of strong economic activity as firms invest in technology to improve productivity. * Should be short-term as workers re-train but often older workers find this difficult and the pace of change has been very rapid.   Frictional unemployment   * Labour market is imperfect and it takes time to match labour demand with supply. * Likely to increase in a boom as workers feel confident they can leave a job and find another easily. Averages 1-2% over course of business cycle. * Likely to be short-term in duration | 1-2 marks   * 1. marks   1-2 marks  1-2 marks  1-2 marks |

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| (b)  Inflation output effects   * Real incomes fall if wages do not increase in line with inflation * Interest rates will rise to maintain real rate of return. * International competitiveness will decline as domestic exports become more expensive compared to trade competitor prices * Inflation creates uncertainty for business investment and household savings * If wages rise to match inflation: labour for capital substitution * Individuals will seek a hedge against inflation through speculative (non-productive) purchasing of assets that maintain their value * Hyperinflation can lead to economic collapse as people lose confidence in money as a store of value – this leads to hoarding or non-productive effort.   Inflation redistributive effects   * Depending on extent of interest rises, either borrowers or lenders will gain/suffer. E.g., borrowers benefit as the value of their purchased asset will rise but value of repayments falls. * People on low or fixed incomes will see their real income fall, as there payments do not match the rate of inflation whereas workers with highly demanded skills or strong unions can maintain real incomes. * PAYG taxpayers suffer from bracket creep as they are pushed into higher tax brackets without an increase in real incomes. * Redistributive effects will depend on extent that community sectors have anticipated the inflation.   Unemployment output effects   * Output of economy is less than potential – direct cost on the economy of lost output and income (demonstrated by GDP gap on PPF). * Welfare cost – transfer payments to unemployed are a significant government expense * Opportunity cost – lost taxation receipts and cost of welfare means less can be spent on other sectors such as health and long-term unemployment will reduce future economic growth further constraining ability to meet needs of society.   Unemployment redistributive effects   * Younger workers, middle-aged and minorities tend to be unemployed for longer. Localities in cities are also impacted by varying amounts. People without skills or education/training also more likely to be made unemployed. * Capacity to meet needs is reduced, as unemployment benefits are not large. * Personal, family and social problems arise particularly for long-term unemployed | 1 - 3 marks   * 1. marks   1-2 marks  1-2 marks |

**Question 31** **(20 marks)**

(a) Explain, using suitable examples, how the Commonwealth Government uses its taxation and spending powers to achieve a more equitable distribution of income in Australia. Demonstrate using a Lorenz Curve, the intended effect of the Government policy. (12 marks)

(b) Discuss any two influences or events (domestic and international) that have affected the performance of the Australian economy over the last decade. How has the Commonwealth Government sought to stabilise the business cycle in this time? (8 marks)

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| (a)  Explanation  There is inequality of income in Australia. The Government redistributes income from the rich to the poor to support those who would have little or no income in a pure free-market economy.  This is done by taxation and welfare payments. 40% of total Commonwealth budget allocated to welfare payments  Direct taxation   * Personal income tax (direct tax) is progressive: as income rises, the marginal rate of tax also rises. Largest component of taxation system. * Fringe benefits Tax – levied at the highest marginal rate of tax on the value of non-cash benefits * Capital gains tax – progressive tax on profits from sale of assets (shares, investment properties)   Government payments   * Transfer payments such as pensions and welfare benefits provide direct income support (aged, unemployed, disabled, family allowance) * 40% of total Commonwealth budget allocated to welfare payments * Indirect Government payments such as subsidized education, housing and health enables all Australians to access vital services   Lorenz Curve   * Lorenz curve measures the extent to which a society diverges from absolute income equality (diagonal line). * Impact of Government taxation and payments would be a Lorenz curve closer to the diagonal line. * Correctly labelled and drawn Lorenz Curve   (b)  Influences and events  Categorisations of events/influences will vary depending on student’s explanation.  Any two: Mining boom, Chinese growth, COVID-19 lockdowns/policy, geopolitical tension etc.  Until 2020, Australia had not experienced a recession in almost 30 years.  However, there had still been oscillations in economic activity due to domestic and international influences and events.  Australia is a small open economy and it has generally benefited from this trade exposure.  After the GFC, a mining boom based on rapid Chinese industrialisation and demand for iron ore and coal saw a rapid increase in export volume (commodity prices rose rapidly due to the excess demand).  Resources States such as WA and Queensland particularly benefited. The construction and investment boom lasted until 2015-16 when it gave way to a less labour intensive operational phase.  The mining boom led to a rapid rise in standards of living. However, the exchange rate rose due to the mining sector export prices and volumes. Some industries could not compete and closed such as vehicle manufacturing.  Political tensions between the Chinese and Australian governments also saw a number of Australian goods (wine, barley) affected by tariffs. This reflected ongoing geopolitical tensions and increasing protectionist behaviour globally and especially between China and the USA.  Decline in oil prices mid 2010s and a movement towards non-fossil fuel based energy sources has also kept cost-push price pressure relatively low.  Impact of Corona Virus pandemic in 2020 saw a government induced shutdown to limit movement, which resulted in Australia having two negative quarters of growth. Sharp recovery but impact is lingering due to periodic State based shut downs throughout 2021.  Government macroeconomic management  During the growth periods, Australian government budget deficits have contracted in size. The pandemic however resulted in a massive deficit as government support payments (Job keeper) and public investment projects were rolled out to support the economy.  Monetary policy saw a stabilisation of the cash rate during the mining boom but since then it has been progressively loosened until it is now at a record low level (0.1%). | 1-2 marks  1-3 marks   * 1. marks   2. marks   1-6 marks  1-2 marks |