

**Year 12 Economics Exam Semester 2 2020**

**Marking Guide**

**Section 1 (24 marks)**

1 C

2 D

3 A

4 C

5 D

6 B

7 A

8 B

9 A

10 B

11 A

12 C

13 C

14 D

15 D

16 B

17 C

18 A

19 C

20 B

21 D

22 A

23 B

24 D

**Section 2 (36 marks)**

**Question 25 (12 marks)**

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| a. i. Annual growth rate = 1.4%  ii. Investment - 0.9%;  Net exports 1.1% | 1 mark  1 mark  1 mark |
| b. Significant contribution from G due to increased spending related to the bushfires & large stimulus package due to the Covid crisis  Significant contribution from NX due to very large **decrease** in spending on imports (because of decrease in C & I). Even though contribution from exports is negative, the larger collapse in imports means NX makes a positive contribution | 1-2 marks  1-2 marks |
| c. 2 marks for explanation; 3 marks for model  The bushfires will lead to a decrease in AS (shift left) while the health crisis will cause a large decrease in AD (shift right)  The combined effects will cause a large decrease in real GDP, a large rise in unemployment & a fall in the price level (inflation rate)  Draw a correctly labelled AD/AS model showing both shifts of the curves & the resulting fall in real GDP & the price level | 1 mark  1 mark  1-3 marks |

**Question 26 (12 marks)**

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| a. i Trade balance = $13,500 million or $13.5 billion (allow +/- $500 million 0r $0.5 billion)  ii Commodity price index = 98  iii AUD = US$0.70 or US70 cents | 1 mark  1 mark  1 mark |
| b. i There is a very strong positive relationship between the commodity price index and the trade balance: as commodity prices increase, the trade balance increases & vice versa. This is clearly seen in the graph. (reference to statistics)  Commodities such as iron ore, coal, LNG, make up most of Aust’s exports. An increase in their price directly increases the value of Aust’s exports which increases the trade balance. | 1 mark  1-2 marks |
| b. ii Between 2018-2020 when the AUD depreciates there is a corresponding increase in the trade balance. (reference to statistics)  There is usually a negative relationship between the AUD and the trade balance. For example, as the AUD depreciates, the trade balance increases because exports become cheaper to foreign buyers while imports become more expensive. | 1 mark  1-2 marks |
| c. No, the graph does not support a positive relationship between the commodity price index and the AUD – for example between 2018-2020 there is an increase in the commodity price index, but the AUD depreciates.  The main reason is the AUD is dependent on the interest rate differential between Australia & the US. During this period Australia’s i/rs were falling relative to the US which reduced demand for AUD & counteracted the effect of rising commodity prices. | 1 mark  1-2 marks |

**Question 27 (12 marks)**

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| a. i. 0.25%  ii. Full employment: 4.5%  Inflation: 2 – 3% | 1 mark  1 mark  1 mark |
| b. A decrease in real GDP for two successive qrts (or two successive negative qrts of real GDP growth)  A fall in the inflation rate reflecting decrease in demand & spending across the economy the March qrt inflation rate was actually negative  3rd indicator: a decrease in household consumption (negative growth in C) would be a clear sign of a deep recession (reflected in falls in retail sales & new car registrations) given that C rarely falls; a decline in investment on its own is probably not sufficient to be an indicator of a recession | 1 mark  1 mark  1 mark |
| c. FOUR channels:  1) Cost of borrowing – a cut in i/rs reduce the cost of finance encouraging more people to borrow and spend  2) Cash flow – a cut in i/rs reduce repayments on existing loans giving borrowers more cash flow to spend  3) Asset prices – a cut in i/rs will increase asset prices such as property & shares which increases household wealth & stimulates spending  4) Exchange rate – a cut in i/rs will depreciate the AUD increasing net exports  Channels (1) & (3) will not be very effective in a recession but channels (2) & (4) will. Cash flow will increase & the AUD will depreciate helping to increase spending. | 1 mark  1 mark  1 mark  1 mark  1-2 marks |

**Section 3 (40 marks)**

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

(a) Explain the cyclical and structural factors that have led to this outcome. (12 marks)

(b) Discuss the significance of a sustained current account surplus for the Australian economy. (8 marks)

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| (a) The current account is in surplus when the sum of exports and income receipts from foreign residents exceeds the sum of imports & income payments to overseas residents. Aust’s current account because there has been a significant increase in Aust’s trade surplus which has exceeded the usually large income deficit.  Cyclical Factors – these factors influence the trade balance & have been the most influential in creating a current account surplus  1) Terms of trade (commodity prices) – Aust’s terms of trade have been rising over the last few years mainly due to stronger commodity prices. This has led to an increase in the trade balance.  2) AUD – the AUD has depreciated over the last few years providing a competitive advantage to exporters (from lower prices) & discouraging imports (due to higher prices). This has helped to increase Australia’s trade balance.  3) Aust’s weak domestic economy – this has decreased domestic spending, esp private investment, which has reduced spending on imports and helped to increase the trade surplus.  Structural Factors – these factors influence the income balance  Because of Aust’s large dependence on foreign investment, Aust has a high level of net foreign liabilities. The payments associated with foreign liabilities (interest & dividends) is recorded in the income account & is the reason for Aust’s large income deficit. Given that Aust’s savings now exceeds its investment (S > I), there is less need for foreign investment & so income payments have started to fall reducing the income deficit. | 1-3 marks  1-6 marks  1-3 marks |
| (b) Significance of a current account surplus  1) A current account surplus will contribute positively to real GDP growth which helps to boost employment and real incomes. (student could also approach this question using current conditions where fall in M spending is causing CAS thus the CAS is a symptom of a slow economy with rising UE and falling inflation)  2) A current account surplus means that the capital & financial account will be in deficit since the two accounts must balance to zero.  This means that Aust’s foreign investment abroad exceeds foreign investment into Australia. This has important implications for the income category in the current account and for Australia’s bet foreign liabilities. The income deficit will start to fall because there will be less capital inflow into the Australian economy. At the same time, Australia’s foreign assets will increase relative to its foreign liabilities reducing Aust’s net foreign liabilities.  3) A current account surplus means that Australia has a positive savings investment gap (S > I). This means that Aust can fund all its investment from its own savings pool & therefore does not need to rely on foreign debt. | 1-2 marks  1-3 marks  1-3 marks |

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

(a) Evaluate four arguments that may be used to justify the use of a tariff. (12 marks)

(b) Use a model to analyse the effects of a tariff on the domestic industry, market efficiency and the macroeconomy. (8 marks)

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| a) Four arguments x 3 marks: 2 marks to describe the argument & 1 mark for evaluation  1) Using tariffs to protect a domestic industry against ‘dumping’ – where a country may sell its goods in a foreign market below cost, thus harming domestic producers. While dumping is not allowed by the WTO, it is often difficult to prove. Low prices does not necessarily imply dumping & maybe the result of greater efficiency.  2) Using tariffs to increase employment & boost income in a particular industry (protect jobs argument) – tariffs will increase production & employment within the protected industry but it will decrease jobs in other industries due to higher costs. Net result is that tariffs lead to a net loss of jobs.  3) Using tariffs to protect an ‘infant’ industry – the tariff will allow the new industry to become established in the market by reducing competition from more efficient foreign producers. If the infant industry cannot survive without protection, then it is inefficient to  4) Using tariffs to protect ‘strategic’ industries – similar to the national defence argument. Certain industries may be deemed ‘strategic’ or essential to reduce reliance on imports during a conflict, & therefore need protection to ensure domestic production. Problem is that every industry can argue that it is ‘strategic’.  Other arguments – to encourage diversification & avoid narrow specialisation | 1-3 marks  1-3 marks  1-3 marks  1-3 marks |
| b) Tariff model – 2 marks; analysis of effects – 6 marks  Correctly labelled tariff diagram showing world price below equil; tariff line; change in qS and Qd after the tariff is applied  Effects:  1) Domestic producers gain from higher price & increase in qty supplied; higher employment & greater income for domestic firms; domestic consumers lose from higher price & decrease in qty demanded  2) Tariff is inefficient since the loss in consumer surplus exceeds the gain in producer surplus + govt revenue – there is a DWL  3) Overall the tariff has a negative impact on the macroeconomy – net loss of jobs, higher costs, slower econ growth | 1-2 marks  1-2 marks  1-2 marks  1-2 marks |

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

(a) Discuss the importance of consumption as a component of aggregate expenditure to the Australian economy and explain the factors that can influence the total amount of consumption spending in Australia. (10 marks)

(b) Use the aggregate expenditure model to demonstrate and explain the effect of a change in autonomous consumption and a change in the marginal propensity to consume. (10 marks)

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| a) The importance of consumption (1-2 marks)  Definition of consumption; around 55% of aggregate expenditure; most stable component of AE  Factors affecting consumption – discuss at least THREE factors  1) Income – disposable income is the main factor affecting consumption; basis to the consumption function: C is a positive function of Y  2) Household Wealth – changes in value of assets such as property; share portfolios; superannuation funds; an increase in wealth will shift the C function up  3) Interest rates – consumers often borrow to purchase consumer durables such as cars, boats, travel; furniture; home improvements; as i/rs fall, C increases  4) Expectations – consumer expectations about the future will affect consumer’s current purchasing decisions | 1-2 marks  1-8 marks |
| b) i. Effect of a change in autonomous consumption (5 marks)  Explanation – 3 marks; model – 2 marks  Define autonomous C; give an example; explain how an increase in auto. C will shift the C function up & have a multiplier effect on real GDP  Correctly labelled AE model showing an increase in C function resulting in an increase in equil. Real GDP.  ii. Effect of a change in the mpc (5 marks)  Explanation – 3 marks; model – 2 marks  Define the mpc; give an example; explain how an increase in the mpc will increase the slope of the C function (swivel up) which will increase the size of the multiplier & increase equil. real GDP.  Correctly labelled AE model showing an increase in the slope of the C function (steeper) resulting in an increase in equil. Real GDP. | 1-3 marks  1-2 marks  1-3 marks  1-2 marks |

**Question 31 (20 marks)**

Discuss the current fiscal policy setting of the Government with reference to the business cycle and evaluate its effectiveness in achieving the government’s economic objectives. Use the aggregate demand/aggregate supply (AD/AS) model to support your answer.

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| Current fiscal policy (1-4 marks)   * Current fiscal policy: govt has introduced a number of stimulus policies to support private demand, both consumption & investment * Increased jobseeker, introduced jobkeeper, direct income payments to low income households & small business sector * Size of stimulus approx. $200bn (10% of GDP) * Result will be a massive increase in the budget deficit * Stimulus designed to increase AD to offset the large negative shock | 1-4 marks |
| Reference to the business cycle (1-4 marks)   * Coronavirus has pushed the economy into a recession – the first since 1991 & the biggest contraction since the Great Depression of the 1930s * March qrt GDP growth rate fell by 0.3%; June qrt expected to be even larger contraction; unemployment rate increased to over 7% & expected to rise to 10%; C & I both decreased; annual inflation fallen to around 1% (March qrt negative) | 1-4 marks |
| Govt’s economic objectives (1-4 marks)   * Econ growth – target is around 3-3½%, but this will not be achieved this year; economy likely to record negative annual GDP growth * Full employment – target is around 4½%, but this will not be achieved this year; U rate will continue to rise through the year & approach 10% * U rate has been kept artificially low due to jobkeeper scheme * Inflation – target is around 2-3%, but this will not be achieved this year; currently annual rate just over 1% & expected to remain low due to lack of spending & demand | 1-4 marks |
| Effectiveness of fiscal policy (1-4 marks)   * Fiscal policy is far more effective than monetary policy when the economy is in a recession – this is because G is a direct component of AD (AE) & so increases in G will have immediate & multiplier effects throughout the economy * The effect lag is very short for fiscal policy * The govt can open a spending tap & target spending to specific sectors & income groups if necessary * The govt can quickly raise funding (finance its budget deficit) through the selling of govt bonds either to domestic or foreign residents * The multiplier effect is likely to be stronger when the economy is in recession since inflation is very weak | 1-4 marks |
| Use of the AD/AS model (1-4 marks)   * Correctly labelled AD/AS model showing the economy initially below potential GDP (to the left of the LRAS curve) * Show effect of Coronavirus as large decrease in AD; can also show a decrease in AS but the main effect is the AD shock * Show effect of shock(s) on real GDP & price level – decreases in both (& increase in U rate) * Explain that purpose of fiscal policy stimulus is to stop the AD curve from further decreasing & hopefully shift the AD curve back towards potential GDP. | 1-4 marks |