ASSESSMENT REPORT 2020

ECN315116 – ECONOMICS

Note:

Some of these answers and comments go beyond the expectations required by students. The information is included to give current students added information. For Section A and B, the depth of student answers should be guided by the amount of space provided on the exam paper.

SECTION A

Question 1

- Strong responses. Used textbook information around market failures and related their answers back to the concept of socially acceptable outcomes.
- Markers did give some credit to students who spoke of opportunity cost; however, the focus of this question is market failure. Generally, students failed to adequately discuss the workings of market forces and the price mechanism.
- Some students mistakenly gave lengthy definitions of scarce resources.
- Some students mistakenly gave solutions to the failures and wasted time explaining how price ceilings/floors could be used to address failures.

Question 2

- Strong responses identified, explained, and related questions to an economic system. Reference to one system, either free market, mixed market or planned system was acceptable.
- Some students gave too much of an introductory preamble, although some understanding of an economic system was useful.
- Candidates who set out their answers in paragraphs and linked their examples to economic system generally had better clarity of expression.
- Some candidates confused "For whom to distribute?" with transportation issues, as opposed to focusing on equity of distribution.

Question 3

- This was a popular question and answers were generally of a high standard. Almost all students mentioned transfer payments and the progressive taxation system.
- Stronger answers explained how transfer payments and the progressive tax system acted in an automatic manner. Most students showed a good understanding of fiscal policy. Stronger answers discussed difference in time lags between the two. Diagrams of the economic cycle were effective where they were supported with a thorough explanation of automatic stabilisers.

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- Weaker answers were unable to provide an example of discretionary economic policy. Where answers had an example of discretionary policy linked to transfer payments, there was some confusion with transfer payments and automatic stabilisers.

Question 4

- Markers accepted a range of responses for this question, as long as students differentiated between types of policy. Responses that included examples of each policy were better.
- Generally, answers were of a high standard.
- Stronger responses made a point of the fact that microeconomic policy is supply sided and targets a specific sector of the economy. Graphs showing the difference between microeconomic and macroeconomic policy were useful where they were supported with explanations.
- Weaker answers confused fiscal and monetary policy.

Question 5

- This question was a real test of students' understanding of foreign transactions.
- Stronger responses mentioned that foreign debt and investment can flow both into and out of Australia. Weaker answers confused foreign investment with Australia investing in overseas currency/funds. Some students stated that there is no benefit to having a foreign debt, but the benefit comes from the foreign investment or borrowings.
- Stronger answers used examples to clarify their explanations and discussed the implications for the Balance of Payments. Most responses correctly identified how foreign debt and investment into Australia can benefit the economy.

Question 6

- This was a popular question and answers were generally of a high standard.
- A wide range of factors were accepted with stronger responses incorporating rich economic terminology to explain how the factors contributed to globalisation. Some of the range of factors accepted include the textbook factors such as those outlined in chapter one; discussions on specialisation and comparative advantage; and components of the definition for globalisation (as per the glossary).
- Additionally, markers accepted very specific factors such as the use of containerised shipping.
- Candidates needed to discuss the factors from an economic viewpoint. Weaker responses used non-economic factors e.g. the role of social media without establishing a link with global trade, whereas stronger responses focused on economic factors e.g. financial flows.

SECTION B

Question 7

A brief inclusion of what is the Production Possibility Frontier (PPF) was incorporated into better answers. Inclusion of relevant economic terms and concepts, such as 'opportunity cost' and the role and use of 'resources' into answers was appropriate.

Diagrams, on the whole, were completed well. Some students drew their own diagrams in order to more neatly and clearly communicate.

(i) The question was straightforward, with students needing to explain that at point 'X' the economy was allocating all available resources to the production of primary products, with the opportunity cost being foregoing all production of manufactured goods. The opposite scenario needed to be explained for point 'Y'.

(ii) New technology pushed the PPF outwards for manufactured goods only. Students needed to explain why this was the case and what the impact of this scenario had on the production of primary products. Better answers incorporated into their answer that the opportunity cost of producing primary products had increased.

(iii) Skilled migrants pushed the PPF outwards for both products. Students needed to explain why this was the case and the impacts of this for the economy.

Question 8

This question was straightforward, easy to interpret and was well answered overall. The question specifically asked for the impact on 'market price' and 'market quantity' – not all students did this, with many referring to their diagram instead or just making a simple reference to price and quantity.

Students should have briefly incorporated into their answers the relevant factor affecting demand or supply that had changed. A brief explanation of the impact of the change, creating a shortage or surplus of supply, was incorporated into some answers but was not required.

(i) A decrease in supply with market price rising and market quantity falling.

(ii) An increase in demand with market price rising and market quantity rising.

(iii) An increase in supply with market price falling and market quantity rising.

Question 9

Students needed to interpret the diagram and realise the 'y' axis was Real GDP and not % change in Real GDP. Space was limited for explanation, but better answers made reference to relevant stages of The Business Cycle.

(i) Point A represented a period of very low growth in Real GDP, being below targets for sustainable economic growth. In terms of the business cycle, this would be a downturn or trough. This level of growth would not be enough to sustain employment levels, leading to an increase in unemployment or underemployment. Some students referred to the need for levels of growth in real GDP to be above 2% in order to maintain employment, due to productivity improvements and population growth. Inflation would also be low due to the absence of inflationary pressures (weak growth in Aggregate Demand), in particular 'demand pull inflation'.

(ii) Point B represented an upturn in the Business Cycle. This would be characterised by growth in Real GDP, fueling consumption and investment, resulting in an increase in employment of resources by business in order to meet the increased levels of Aggregate Demand in the economy. A brief explanation of why inflationary pressures would be rising, in particular, demand pull inflation was required. Mention of the RBA's target range of 2%-3% could also be mentioned.

Question 10

Knowledge of the formulas used for calculating employment statistics was an essential component of this question, with many students struggling in this regard. For example, calculating the size of the labour force was not completed well. Rounding to the nearest decimal point was required as this is a standard representation in publicly released data, e.g. from the ABS. Two decimal rounding was also acceptable.

(i) 66%

(ii) 5.1%

(iii) The answered centered on an increase in the Labour Force due to discouraged job seekers (hidden unemployed) registering as being unemployed in the hope of finding employment in the improved job market. An increase in the size of the labour force may result in a rise in unemployment if these job seekers do not subsequently find employment. Structural change resulting in a mismatch of skills (structural unemployment) was not a correct answer to this scenario.

Question 11

A brief definition of comparative advantage could be provided but the main focus of this question was for students to calculate comparative advantage. Many students provided data regarding Absolute Advantage, which was not correct. Calculations needed to have been completed, clearly indicating which economy had comparative advantage.

(i) Economy A had comparative advantage in product X as the opportunity cost was 0.5 million tonnes of Y, whereas Economy B's opportunity cost was 1 million tonnes of Y.

(ii) Economy B had comparative advantage in product Y as the opportunity cost was 1 million tonnes of X, whereas Economy A's opportunity cost was 2 million tonnes of X.

(iii) Overall production of X and Y would be higher than if the two economies attempted to produce both X and Y. The two economies, by trading surplus production, would benefit from increased production at cheaper prices with higher quality production due to specialisation. As a result, more wants can be satisfied in both economies, resulting in a high standard of living.

Question 12

Interpreting graphs is relatively straight forward, meaning that students should incorporate relevant economic knowledge into interpretations. For example, using terms such as deficit and surplus balances, exports and imports of goods and services. Knowledge and understanding of the composition and reasons for the movement in the Current Account was needed for part (ii).

(i) The Net Primary Income deficit, from 2015 to 2018, steadily declined from approximately minus $8 billion to minus $15 billion, with a slight improvement in 2019 to a minus $11 billion deficit. The Net Goods and Services (exports of goods and services minus imports of goods and services) improved from a deficit of $9 billion to be a surplus of $15 billion by 2019, with a short-term decline to a small deficit in 2017.

(ii) The Current Account is comprised of three aggregates – Balance of Goods and Services, Net Primary Income and Net Secondary Income. Linking the trends and aggregates in the graph to arrive at the Current Account Balance was necessary. Better answers detailed the cyclical nature of the BOGS and that the growth in the surplus of the BOGS was due to the increase in exports in the past five years, relative to imports. This growth in the BOGS was enough to counteract the deficit in the Net Primary Income account to the extent that the Current Account was in surplus by the end of 2019. Some students linked this improvement in the Current Account to a slight decline in the servicing costs in the Net Primary Income account.

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SECTION C

Question 13

(a) The direct economic issue arising for the Australian economy from the health crisis is that GDP growth has been severely curtailed through reductions in components of aggregate demand – consumption, investment and export – particularly in education, transport and tourism sectors.

The loss of consumer and business confidence through uncertainty, the closing of businesses to reduce transmission of the disease, with consequent loss of business and employee incomes have seen a decline in consumption expenditure on the part of individuals, and capacity to employ and invest by business.

Because of the need to close borders and restrict international travel, Australia is particularly hard hit because of the high importance of tourism and provision of education services to foreign students as components of Australia's exports.

(b) An interest rate reduction will have two effects on consumers. Borrowing becomes cheaper and therefore is more attractive. Also saving is less attractive and therefore consumption may increase. Both these aspects should lead to an increase in the level of household expenditure on goods and services, and hence increase aggregate demand. If the interest rate reduction causes a depreciation, then imports become relatively more expensive in A$ terms and so demand may swing to domestic product.

Businesses will find borrowing cheaper and hence projects that may have been uneconomic become economic. Businesses can fund new opportunities. If the interest reduction causes a depreciation in the domestic currency (as it may) then businesses that export find that returns in Australian currency are increased, and import replacing businesses may also gain as imports become more expensive in A$ terms.

These expenditures are components of aggregate demand. Increases in aggregate demand should increase GDP growth as discussed above. This increase may not occur if confidence is very low, and in the situation where the cash rate is very low and the RBA has run out of conventional monetary policy options.

(c) Stronger answers clearly discussed all three sectors separately. Individuals can be impacted by the lack of employment opportunities afforded by a slow growing economy. The rate of unemployment and underemployment will be higher than in a faster growing economy. There will be a loss of economic welfare for those unable to find sufficient employment.

Low growth will impact businesses by restricting their capacity to expand, and thus their capacity to employ. It will also lead to a delay in investment expenditures, as return on investment will be seen to be less sure than in a period of high growth. Some businesses may also fail.

Governments cannot expand their revenue base and may have higher transfer payment costs in paying for welfare benefits for those losing employment or suffering reduced hours. Fiscal policy measures to promote growth may further erode Government funds or require borrowing, leading to future obligations to service debt.

(d) The following reasons are identified in the extract. The use of headings by students is appropriate and aids in communication.

Low interest rate

Supports increased borrowing by households and business, and consequently an increase in consumption and investment expenditure. Also, less incentive to save due to relatively low return.

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High infrastructure spending
Such expenditure (primarily funded by governments) provides income to businesses contracted to build the infrastructure and income in the form of wages to those employed by those businesses. Both increase the capacity to spend in the form of consumption and investment.

Lower exchange rate
Australian exports now relatively cheap to overseas buyers and therefore increases competitiveness and sales of exporters.

Strong investment in resource sector
Again, investment here increases exports and income to those employed in resource extraction.

Recovery in residential construction
Increased income to businesses involved in construction. Strong multiplier effect.

Recovery in household consumption
Household consumption is by far the most important element of aggregate demand (approximately 60%).

(e) A range of responses was accepted for this question. Whilst interest rates are an expense to a borrower, they are income to a financial asset holder. People relying on such income – for example self-funded retirees and pensioners on part support – are an adversely affected group in society.

Housing affordability was also mentioned as an issue in the article. A practical limitation of the reduction in interest rate (particularly when rates are very low) is that there is no certainty that consumers or businesses will respond in the desired manner – that is, increase borrowing and hence spending.

A second limitation is that the interest cut cannot be directed – it must influence the entire economy. It could be that this restricts the suitability of the interest rate cut, if it adversely affects a particular element in the economy.

(e) Variety of responses available to this question. Some points may include:

- Through fiscal measures the government can direct expenditure toward specific areas of the economy. Such measures as investment allowances, accelerated depreciation and specific subsidies can be designed to improve investment and employment. Such measures must be funded from the government budget which eventually relies primarily on taxation inflows.
- Students were rewarded based on the reasoning (justification) of their answer.

Question 14

(a) In Australia the RBA normally exercises monetary policy through its ability to influence the level of interest rates. In order to support economic growth, the RBA will take an ‘expansionary stance’ and will reduce the cash rate – a signal for other interest rates to fall. In the reading it is mentioned that the rate has fallen to 0.5%. This means that there is very little left for the RBA to reduce and any cuts will be small and have limited impact. Also, at very low interest rates it is unlikely that further reductions will result in a marked increase in borrowings and expenditure due to lack of confidence about the future.

Therefore, in the absence of effective monetary policy to influence aggregate demand, it falls to the second arm of macro-economic policy – fiscal, or budgetary, policy.

(b) Many students began by stating that AD= C+I+G+(X-M) and went on to identify those that were targeted. The stimulus package directly addresses consumption expenditure, investment expenditure and government expenditure. Consumption expenditure is expenditure on goods and services by individuals (households).

Increased welfare and the Jobkeeper programs targeted consumption while investment was targeted through cash flow support directly to businesses. Government expenditure relates to expenditures by governments on goods and services and in providing infrastructure. Students were asked to identify and describe the components targeted by the package.

(c) Effects upon individuals

In the short term, individuals who are on social benefits receive cash payments, enabling them to make expenditures immediately that they would otherwise be unable to make. Support of apprentices and the Jobkeeper elements allow employees who lose employment due to business shutdown to be paid a wage and remain 'attached' to the workforce.

Income support also enables individuals to maintain expenditures – particularly in meeting financial obligations such as mortgage repayments.

In the longer term this approach should result in fewer individuals leaving the workforce, and hence being better prepared to contribute to economic recovery as it occurs. However, the effects of the consequent massive budget deficit created will fall heavily on future generations.

Effects on business enterprises

In the short term, the stimulus package (through payments in the form of cash support and Jobkeeper) allows those businesses that would otherwise fail due to incapacity to cover costs (in particular wage costs) as demand falls, to continue to operate, or at least to maintain staff levels. In the longer term those businesses that are successfully assisted to survive will provide future employment and contribute to future economic growth.

Governments

The Commonwealth Government has had to borrow heavily to fund the massive levels of stimulus spending. In the short term this has allowed programs to be funded to offset the effects on individuals and businesses of the recession brought about by the health crisis. In the longer term there is a very significant budget deficit to be funded which will impact upon the capacity of future governments to fund programs.

(d) Strong answers identified the three elements of the package from reading two and went on to analyse how each of these would impact aggregate demand and economic activity. Some students referred back to points made in part (b) and this was accepted. Acceptable responses included parts of the following:

Cash payments to individuals on social benefits, increased levels of social benefits and wage support such that employees continue to be paid, will all directly influence consumption expenditure. People will be able to continue spending on goods and services whereas without assistance they would not. As much of the stimulus is being directed at social benefit recipients then it is expected that the effect on consumption will be certain as that group has a higher propensity to consume than those in higher wealth brackets. The effect of the higher consumption expenditure will be to support continued production in the economy and hence GDP growth that would otherwise not have occurred.

Incentives to business to invest will see a direct increase in aggregate demand through the increased demand for new capital goods such as (for example) plant and equipment, vehicles and information technology. This expenditure will have a secondary benefit of improving productivity in the economy and hence improving future economic growth.

By far the most funds have been allocated to supporting employees who would otherwise have lost their jobs and their income. This has resulted in business survival and the capacity to re-employ and expand once the health crisis has passed.

(e) In most 'normal' circumstances the current state of the budget and the likely effect on future budgets would be important limitations on the size of the government expenditure. Because of the extreme nature of the situation these limitations have not had the influence normally to be expected but the capacity to continue with this level of expenditure is a major practical limitation.

In terms of social justice, the stimulus packages are largely directed at those in society who are disadvantaged by the situation – particularly employees who would otherwise have lost income and been forced onto unemployment benefit. The increased Jobseeker has also helped reduce poverty in the short term.

The legacy of massive government deficits into the future can be seen as a social justice issue – particularly as it relates to generational obligations as the repayment of debt will require higher taxes or lower levels of government spending in the future.

(f) A variety of responses were accepted to this question. Stronger answers discussed he need for both a fiscal and monetary policy approach. Most students mentioned that they would not prefer the stimulus left to the Reserve Bank for a variety of reasons, many of which were outlined and given credit in previous parts to this question such as part (a).

A fiscal response can be directed specifically at areas in the economy; it can be quickly designed and implemented, and time-lags can be shortened by targeting recipients who will spend. However future budgets are affected by needing to repay with interest.

An interest rate response can be implemented quickly but has a long time-lag for effect on the economy. It relies on the market to react and respond. It can't be directed (blunt instrument discussion). Preserves government budgets. Problem of effectiveness when interest rates already very low.

Question 15

(a) Interdependence of nations internationally through free trade and removal of barriers to spread of goods and services, jobs, information, and technology. Economic interdependence of countries. Flows of labour, capital, and information. International industrial and financial business structures.

(b) The criticism in the current crisis relates to the international nature of production, where various stages of production processes are carried out in different countries.

Any failure of international transport and communication will cause disruption of productive processes and hence shortages or non-availability of intermediate goods and other important or 'vital' products such as those relating to health of citizens.

Individuals may be affected in three ways: as consumers of goods, as consumers of services – particularly travel and education and as suppliers of labour. Goods and services which were available through trade have now become more difficult to obtain, thus reducing the range of goods and services available to consumers. International travel has closed and provision of education to international students, a significant contributor to Australian trade, severely disrupted.

Individuals also provide the labour resource. Free trade and globalization resulted in the loss of manufacturing industries in Australia which were unable to compete with overseas producers. Whilst manufacturers who survived have done well, the contribution of manufacturing to GDP has declined significantly.

Individuals who worked in manufacturing lost employment opportunities and have had to move employment to other fields where possible. Businesses have been affected through interruptions to supply chains, loss of business.

Other issues

- growing inequality between low wage countries and developed countries
- destruction of manufacturing industry in Australia. And hence technology, skills and employment – example car industry
- defence argument
- infant industry argument
- self-sufficiency argument
- employment argument

(c)

- environment
- shift of manufacturing to low wage countries with less strong environmental standards
- social justice
- loss of jobs in manufacturing industry in Australia.
- poor working conditions in low wage countries/ child labour

(d) main options:

- tariff
- quota
- subsidy

Discussion needed on how each provides protection for domestic industries.
Could also include other industry assistance measures

(e)

Individuals benefit from having employment opportunities in protected industries, including exposure to the skilled training involved in such industries. The main cost of protection to the individual is higher prices – not only of the imported goods, but of Australian produced goods which have been protected from competition by tariff or quota, or which have an input of imported intermediate goods. There will also be some lessening of choice of product as imported product becomes less competitive within Australia.

Businesses benefit directly from protection – it reduces competition and allows otherwise marginal businesses to survive.

The cost – if it can be seen to be a cost – is that domestic businesses are able to operate inefficiently, and so do not have an incentive to become more efficient and embrace technological advancement.

Insomuch as government has responsibility for the security of its citizens, trade protection can be implemented such that strategic industries can be maintained within Australia, so that in times of international turmoil the country can better cope. Some industrial capacity can be maintained where otherwise it may disappear through inability to compete with overseas countries.

Where the protection is in the form of subsidy or special grant there is a direct monetary cost to government; but in the case of tariffs the government derives a monetary benefit.

(f)

Social justice matters – higher prices on protected product fall more heavily on low income earners. They are paying more for product than they would without tariffs or quotas. Trade protection may give employment to classes of employee who represent particular social groups such as recent immigrants for example factory work requiring a semi-skilled work force.

Question 16

(a) The Australian currency is established by market forces – it is a floating exchange rate. This means that the rate of exchange (the price of the Australian currency in terms of another currency) is determined by the interaction of demand for the currency and supply of the currency. (Graph may be used to illustrate.)

(b) The causes are clearly suggested in the extract. Candidates select any three to discuss.

Iron ore price boom
In order to purchase iron ore from Australia foreign buyers must convert their currency to Australian currency. As the iron ore price increases so there is a need for more of the currency. This increases demand for the A$ and hence the price (exchange rate).

Confidence in the global economy
As investors become more confident of the future, they are prepared to take investment opportunities. Overseas investors moving funds into Australia increase the demand for the A$. May also lift expectations of future appreciation of the A$.

Aussies trapped at home
Money spent overseas is equivalent to spending on imports. A$ need to be sold (exchanged for other currencies) in order for spending to occur in other countries. When Australians spend more overseas there is an increase in supply of the currency, which should see a reduction in price of the currency – a depreciation of the exchange rate. As Australians are currently unable to travel this spending cannot occur and therefore the effect on supply is removed, and with it the downward effect on the exchange rate.

It might also be argued that spending by Australians in the domestic economy as an alternative to spending overseas will increase aggregate demand and hence economic growth above where it would otherwise be. This may add to confidence in the economy and increased attractiveness of investment in Australia.

Record trade surpluses
A trade surplus is a situation where the value of goods sold overseas (exports) exceed the value of goods purchased from overseas (imports). Demand for the A$ increases to enable purchase of Australian product by foreign buyers.

Again, this situation may also improve confidence in the economy.

Relatively high interest rates
Investors will move funds to places offering higher returns. If Australia's interest rates are high relative to other comparatively safe economies, then funds will move into Australia. This increases demand for the A$.

(c) Costs
Australian products become relatively expensive for overseas buyers and therefore less competitive. If demand is elastic, as it is likely to be on world commodity markets, then sales will fall and export incomes fall. (Note situation with iron ore to China however.)

Imports will be less expensive and demand for them will increase. Import competing industries in Australia will face stronger competition and it is likely domestic production of such products will decline.
Foreign investment in Australia becomes relatively more expensive and may therefore decrease – reducing business activity.

The A$ value of income earned by Australians from overseas investments falls, and the value of foreign assets in A$ terms fall (valuation effect).

Benefits
Servicing costs of foreign debt is reduced. More foreign currency can be bought with A$
Debt borrowed in terms of foreign currency will become cheaper to service. Businesses importing intermediate goods should benefit from lower costs.

(d) An appreciation of the currency results in Australian export products increasing in price in terms of foreign currencies. Australia's exports are dominated by commodities and they are sold into highly competitive markets. Any price increase will see a reduction in demand for the Australian product. Those individuals providing labour to producers of commodities in Australia – mining, fisheries, forestry, agriculture, wool, for example – are likely to face decreased demand for their labour.

An appreciation results in decreased prices for imported manufactured goods. There will be increased demand for such product. Domestic industries competing with imports will be less competitive. Individuals working in these industries will see reduced demand for their labour

(e) The decrease in interest rates would increase pressure for a depreciation of the currency. This is because investment in Australia becomes less attractive and funds will shift to more attractive economies. This will increase the supply of A$ with a consequent reduction in 'price'; that is, a depreciation of the currency. Individuals would be affected as imported products would become relatively more expensive.

Businesses which export product would be more competitive – so Australian primary producers, in particular, would benefit. Import replacement businesses would also benefit as they become more price competitive. For both individuals and businesses repayments of foreign liabilities expressed in foreign currency would increase, but earnings from overseas investments would also increase in A$ terms.

(f) Social justice
The exchange rate in part determines the relative performance of sectors of the economy. Depreciation of the A$ favours primary producers and other exporters as they become more price competitive. Thus, business owners and employees working in these areas are favoured over those in other sectors. A depreciation of the A$ also increases costs for those businesses relying upon imports of their raw materials or intermediate goods. These businesses become less competitive and therefore owners and employees suffer as profits fall and marginal businesses may fail.

Consumers on low incomes may also suffer as prices of many consumer goods increase in A$ terms. Australia imports a very large proportion of its consumer durables (manufactures).

Environment
Depreciation of the A$ improves competitiveness of Australian primary producers. Three of Australia's major exports are coal, iron ore and gas. The extraction and use of coal and gas is seen to be damaging to the world environment, whilst fueling the Chinese demand for iron ore may be seen as supporting pollution creating industry. Therefore, conclusion that exchange rate does have role in both social justice and environment.