The below comments include suggestions in relation to thorough answers, including more information than may be required. Students should be guided by the space provided for answers on the examination paper and ensure that all parts of your response are relevant to the question.

**Question 1**

**Explain the concept of opportunity cost.**

Students needed to explain this concept in addition to providing a definition of opportunity cost. A definition such as that contained in the text book glossary is appropriate. The full explanation may have included a discussion of real or economic cost (i.e. not monetary, benefits of alternative foregone), scarcity and the economic problem (limited resources, infinite wants), competing wants, making a choice and ranking alternatives.

**Question 2**

**Explain the difference between a pure market economy and a mixed market economy.**

This question required an outline of the differences between a pure market economy and a mixed market economy. Many students defined each economic system too briefly, focusing entirely on the absence or presence of government intervention. Better responses discussed each economic system and then differences between the two.

**Question 3**

**Explain the concept of market equilibrium.**

This question required an explanation of the concept of market equilibrium, rather than the point on a market diagram where the supply and demand curves intersect. A diagram was useful to illustrate the concept however more than an explanation of a point on a graph was required. Better answers included that buyers and sellers were both able to buy/sell quantities they preferred at market equilibrium, that quantity demanded equals quantity supplied, the market clears with no excess demand (shortage) and no excess supply (shortage), and that there is no tendency to change at market equilibrium.

**Question 4**

**Explain the concept of price elasticity of demand.**

The best answers began with a definition of the law of demand, a definition of price elasticity of demand and then proceeded to explain price elasticity of demand in the context of expenditure/outlay/revenue changes in response to price changes.
Question 5

Explain the concept of the business cycle.

A diagram was useful here however if included, labeling the axis was required, rather than a simple wavy line on a graph. It was expected that a definition of the cycle as a representation of the level of activity in an economy over time, with a tendency toward a cycle of growth and decline, or thereabouts, would be included. Better answers explained the four stages of the cycle and labeled these on their diagram, i.e. boom, down turn or contraction, recession and upswing or expansion.

Question 6

Explain the difference between structural and cyclical employment.

Most students were able to define each type of employment and provide examples. The focus of the question is the differences between structural and cyclical employment, and many students missed this part of the question, addressing it implicitly if at all.

Question 7

What is meant by market failure?

This question requires an explanation of market failure beginning with a full definition and including discussion of either a couple of forms in depth (explained with an example) or several forms of market failure in brief. Many students definition of market failure focused on undesirable outcomes with an emphasis on negative externalities. Students should define market failure in relation to unintended or indirect social (including environmental) and economic outcomes, usually undesirable. Forms of market failure for discussion include: negative externalities, adequate provision of goods and services, abuse of market power, instability in the business cycle and positive externalities.

Question 8

Define globalisation. State one advantage and one disadvantage of globalisation for Australia.

Globalisation was often defined in simple economic terms, when a fuller definition encapsulating cultural integration and improved communication due to technological changes, innovation and increases in our mobility, etc were best. Many students were able to discern one advantage and disadvantage of globalisation for Australia, though a few missed the point ‘for Australia’. The advantages tended to focus on access to a greater number of products and access to cheaper products/imports. Disadvantages tended to focus around increased competition for domestic producers and the threat of cheap imports.
Question 9

Explain the difference between a current account deficit and foreign debt.

This question required students to define both terms and explain the difference between them. A definition of current account deficit which included a brief explanation of the balance of payments and its components was useful. Referring to the CAD as a result for a given period was helpful. A definition of debt as an accumulated balance and a 'stock' rather than a 'flow' further enhanced a discussion of differences.

ECONOMICS EXAM COMMENTS

SECTION B - PART 1

Compulsory Questions

Question 10

Supply shifts to left, Demand shifts to left. Quantity does fall, but change in price will depend upon the relative size of the shifts. Both changes lead to a decrease in quantity demanded and supplied but a decrease in supply leads to an increase in price whilst a decrease in demand leads to a decrease in price. So the new equilibrium is at an indeterminate point or students could refer to their own graph.

Question 11

Withdrawals = I + G + X = 20+10+15 = $45B

Injections = S+ T + M = 10+15+20 = $45B

The aggregate economy is in equilibrium as withdrawals = injections.

Some students tried to use ‘C’. Students should show working and use correct units

Question 12

Participation Rate = 15/20 = 75%

Unemployment Rate = 3/(3+12) = 20%

Most students who lost marks could not remember the ‘Labour Force’
Part 2

Question 13

Inflation Rate Yr3
\[ \frac{121 - 110}{110} = \frac{11}{110} = 10\% \]

Inflation Rate Yr4
\[ \frac{127 - 121}{121} = \frac{6}{121} = 4.96\% \]

Question 14

a) At A, mix of high levels of capital goods and low levels of consumer goods. Consequences: Immediate/short-run consumption/satisfaction of individual needs/wants sacrificed in favour of developing capital base of the economy giving greater future capacity to produce goods to satisfy individual needs/wants. Hence possibly insufficient production devoted to meeting the population’s immediate needs.

b) At B, greater emphasis is placed on production of consumer goods to satisfy individual needs/wants. As a consequence there may not be adequate production of sufficient capital goods to ensure future production of goods (both capital and consumer) remains at the same level in the future. There may not be sufficient new capital goods produced to replace existing capital goods let alone generate new capital with which to expand the economy.

Question 15

March 2010 to Nov 2010 RB contractionary MP increasing the cash rate to slow the economy.

Nov 2011 to May 2013 expansionary MP decreasing the cash rate to stimulate the economy.

NB. The dates used also show there were significant periods of no action by the RB. Eg Dec 2010 – Oct 2011, June 2010- Oct 2010, etc..

Question 16

a) Multiplier \( K = \frac{1}{mpc} = \frac{1}{0.25} = 4 \)

b) Change in Aggregate Demand \[ K \times \Delta G = 4 \times \$20\ billion = \$80\ billion \]

New level of Aggregate Demand \[ 500 + 80 = \$580\ billion. \]

Students who lost marks forgot to add the $80bn to the original Aggregate Demand $500bn

Question 17

\( P_1 \) is a price ceiling.

In this market the equilibrium quantity and price for taxi fares is \((P_E, Q_E)\).
With the price ceiling:

- At \( P_1 \), \( Q_D = \text{Quantity Demanded} \).
- At \( P_1 \), \( Q_S = \text{Quantity Supplied} \).
- Since \( Q_D > Q_S \) there exists Excess Demand of \( (Q_D - Q_S) \) for taxi fares at price \( P_1 \).

Consequence of the government’s price ceiling is that

1. Some customers willing/able to pay the market rate will now be unable to obtain a taxi \( (Q_E - Q_S) \).
2. Some new customers attracted to taxis by the new fare set by government will now attempt to obtain taxi services that did not exist before \( (Q_D - Q_E) \).

**Question 18**

A fall in Investment acts as a reduction in Injections. Students could discuss how this will slow the circular flow and lead to disequilibrium in the circular flow between leakages and injections. They could also discuss how the economy will move back into equilibrium again.

**SECTION C**

**Question 19**

This question focussed on students identifying the role of China as a large importer from Australia, particularly of commodities such as coal and iron ore. Many students identified additional areas of exports to China, such as education, tourism and the emerging dairy market. If the Chinese economy slowed down then the \( X \) component of aggregate demand \( AD = C + I + G + (X - M) \) would be adversely affected. The balance of goods and services would also be adversely affected which would be reflected in a worsening balance of trade. This would then directly affect investment in the industries involved in the export of these commodities, and (would thus adversely affect employment in these industries) but the best answers pointed out that, through the multiplier process this would affect output and employment in other industries. Some students pointed out that the effect across the rest of the economy could be reduced if it resulted in a fall in the dollar, making Australia more internationally competitive. They were rewarded for this.

**Question 20**

The question required students to outline problems that may lead to a high current account deficit, so it required:

a. Outlining problems leading to (rather than caused by) the current account deficit; and
b. Outlining more than one problem.
Some students misread the question and described the adverse effects of a large current account deficit (such as increasing foreign debt and the burden of servicing costs)

Students identified:-

- a high exchange rate
- lack of international competitiveness (export and import substitutes);
- economic downturn overseas reducing demand for exports;
- Economic growth in Australia increasing demand for imports;
- High domestic inflation.
- Lack of domestic saving sucking in foreign investment which required servicing (income section of current account)

Students’ marks were enhanced if their outlines went into the reasons behind these problems emerging, rather than just listing them as problems. For instance lack of international competitiveness could be caused by low productivity due to lack of microeconomic reform. High Australian dollar could be due to the strength of particular industries such as mining causing the terms of trade to rise. Students who mentioned this were rewarded for describing the two speed economy.

**Question 21**

Most students successfully answered the problem by describing briefly what is meant by a mixed market, then identifying at least two problems and describing them in such depth as the time allowed. Other students were successful by describing a greater number of problems in less depth. Students needed to be mindful to discuss the problems, as the question asked, not the solutions. There was not enough time for students to discuss both!

Problems identified included:-

a. Market failure in the provision of goods such as public good, merit goods.

b. Market failure in income distribution;

c. Market failure in resource allocation due to negative and positive externalities;

d. Market failure in the abuse of market power;

e. Market failure in the form of lack of stability causing inflation or unemployment.
SECTION D

Question 22

A number of students spent time outlining DMO which was not necessary. RBA administers monetary policy by influencing interest rates. This will then influence consumption and investment, both elements of aggregate demand. Many students did not mention investment by firms, just consumption or some talked about household investment. These points should have been clear in answers.

With an increase in AD it would be reasonable to expect stimulation of a slow economy. It would then be worthwhile mentioning multiplier. Many also mentioned that existing loan repayments would be reduced and thus a relative increase in income and a rise in consumption.

Some mentioned the impact on the exchange rate (depreciation) and the benefit of this to Export industries and thus increasing AD once again. It was worth acknowledging the time lag that exists with respect to monetary policy and the risk of generating inflation if not monitored.

Question 23

Climate change is a negative externality and the carbon tax allows the market to adjust for this externality.

Without doubt the better answers did include an accurate, labelled and referred to diagram. This showed a decrease in supply, a decrease in quantity demanded and new equilibrium price (higher) and quantity (less). Many answers did not make it absolutely clear why the level of pollution should decrease.

These industries will be driven by market forces to improve technology and thus lower carbon pollution to reduce tax liability.

With respect to non-polluting industries, some made the link to the possibility that they were producing a substitute good and drew a diagram to show how the increase in price of the good produced by the polluting firm will result in an increase in demand for the substitute. Once again, the diagram facilitated discussion.

Question 24

This question focussed on identifying the different nature of the two types of unemployment exemplified:

a. Cyclical caused by low aggregate demand (downturn in the business cycle); and

b. Structural caused by a mismatch between the skills of workers and the skills demanded by employers. (it was good to list some examples)
Candidates described how the macroeconomic policies of expansionary fiscal and monetary policy were suitable for cyclical unemployment, and then described in a little detail the process by which these policies would increase aggregate demand and increase employment. It added complexity to this analysis if students were able to mention limitations of such policies although it wasn’t expected that they do so.

In terms of structural unemployment, many candidates focussed on spending on education and training as a response. Candidates varied as to whether they characterised this as ‘targeted fiscal policy’ or as a form of ‘microeconomic policy’ (because it was targeted at particular industries or markets). Either description was acceptable if students justified themselves adequately. Some students spoke about the ‘opportunity cost’ or ‘trade-offs’ of employing government money for this purpose, which showed a complex approach.

Fewer candidates talked more generally about microeconomic policy alleviating structural unemployment in the long run, by rendering markets more allocatively, technically and dynamically efficient.

Students who referred to ‘short term’ fixes of subsidising industries or protecting local manufacturers did better if they pointed out that such policies, although successful in the short run, are likely to have adverse effects in the long run in terms of the ability to cope with structural change.

**SECTION E**

**Question 25**

(a) A fall in the $A$ relative to other currency ($US$).
   Thus more $A$ are required to purchase the same quantity of petrol as previously
   So this will increase the price of petrol in $A$ terms

(b) Lower $A$ benefits exporters and Import competing industries.
   This extends to employees and suppliers of such businesses, employees by gaining from improved business outlook for their employer/industry.

(c) Lower $A$ may lead to falling imports and increasing exports. This will be good for CAD. Also tourism etc., will have a similar positive impact. But the lower A$ will lead to higher interest payments on existing debt and this will be bad for the bad for CAD.

(d) Higher interest rates may encourage inflow of funds, therefore increasing A$ as demand for the A$ increases. Falling interest rates may encourage less inflow of funds, and possible a greater outflow of funds therefore lowering A$. NB, this has not happened in Australia even though the Reserve Bank has hoped it would.

(e) As Australia is an island quite distant from its trading partners transportation costs are always going to be of great importance. Australia is also a large country with a small population that is quite scattered.

   Exports must travel long distances to arrive therefore increasing costs for exporters making Australia relatively uncompetitive
Imports must travel long distances to arrive in Australia thereby increasing costs for imports making Australia relatively more expensive.

Because there is such a significant transport element in costs structures in Australia, increasing petrol costs will be passed through the general price structure. There is pressure on all prices to rise if the cost of petrol rises.

**Question 26**

a) Both parties have previously forecast surplus budgets based on revenue projections that have turned out to be incorrect. With lower tax revenues expected and an economy growing weakly, the promised surpluses would either be impossible to deliver without large increases in taxation or falls in spending. This would have a contractionary effect on the economy, so it would be unsound fiscal policy given the weak growth and uncertainty in the global economy. Neither party would want to create a recession in order to keep an election promise.

b) Tax receipts could be lower than expected for several reasons. If GDP is growing more slowly than expected then consumer incomes and consumption will be lower and company profits will be lower and therefore company tax. The same would be true for wages and income tax. The slower than expected growth in China has reduced prices of minerals, making mining companies less profitable and leaving them with a smaller mining tax obligation. Together, this will have a large impact on tax revenues.

c) Mr Swan has said that excessive cuts to government spending would be irresponsible. This means that spending cuts, which would be contractionary fiscal policy, would have negative consequences because of the current phase of the business cycle. Australia is slowly recovering from a downturn, where expansionary fiscal and monetary policy have been used to prevent mass unemployment. Reversing fiscal at this time would probably result in a sharp reduction in aggregate demand, an increase in unemployment, and many businesses closing.

d) A budget may be returned to surplus by reducing spending, increasing taxation or through economic growth. Spending could be decreased through cuts to welfare, health or education. Tax could be increased by increasing the rates of income or company tax or the GST, or by putting in a new tax. The government could also use pro-growth policies, which rely on automatic stabilisers to reduce a deficit and achieve a surplus. As income increases and company profits rise, tax revenues to government increase and welfare, particularly unemployment benefits, fall. This last measure will only work if the budget is in a cyclical deficit, while changes to tax and spending in the long term would be needed to address a structural deficit.

e) During the global financial crisis (GFC), the government used discretionary fiscal policy (on top of the automatic stabilisers) in order to reduce the fall in aggregate demand that occurred due to lower consumption, investment and exports during the GFC. They did this through cash payments to taxpayers and both short and medium term construction projects. This policy helped by partially making up for the shortfall in aggregate demand that had occurred, making the multiplied fall in national income less than it would have been. Australia escaped without actually having a recession, unemployment only rose a little and many businesses survived, which meant that Australia was able to recover fairly quickly as the economy moved to an upswing. This policy resulted, as intended, in a large deficit, which has several problems. It is difficult to move from a...
deficit to a surplus, as this is contractionary and can only be done when the economy is growing slowly. Borrowing for deficits must be repaid with interest payments, and this borrowing may crowd out private investment or contribute to the current account deficit.

Question 27

a) A tariff is a tax imposed on imports. If domestically produced cars are competing with imported cars, they will need to sell at the world price, or close to it. By imposing a tax only on imports, this will increase the price, making the imported vehicles less competitive.

![The Tariff Diagram]

If a tariff was imposed, this would lift the price from $P_w$ to $P_T$ for both imported and domestically produced cars. In the graphs above, this would reduce total demand for cars from 300 to 250 and the quantity imported from 200 units (300-100), to 100 units (250-150). It would also increase domestic supply from 100 to 150. Domestic producers would therefore supply more cars at a higher price, which would give them substantially more revenue.

b) A sustained high dollar has resulted in lower car sales in Australia for Holden. This is due to a fall in exports and an increase in imports. When Australia’s currency is high for a prolonged period of time, foreigners must exchange a large amount of their currency for the same amount of Australian money, which means that the cars we export become more expensive. On the other hand, Australians need to exchange less currency to purchase the foreign currency to buy imported products, so these are now relatively cheaper. The costs of making the cars haven’t changed, but they are now less competitive in a global market.

c) A subsidy is a payment to an industry to help it compete with imports and/or to improve exports. It is a type of trade protection, which, in general, economists are opposed to unless there is a good reason for that protection. Two reasons for protection could be protecting infant industries, or preventing the dumping of artificially cheap imports. As Australia has had a car industry for decades, and there has not been any specific claim of dumping, these do not apply. Economists also oppose subsidies as this is an inefficient allocation of resources. If these industries can’t compete against cheaper overseas producers, it is a sign that we Australia should be allocating our resources to an industry we can compete in, and protection prevents this. It also has a cost to the budget, which could be used to improve services or reduce taxes.
d) Holden is planning on a restructure to make its operations more competitive. If it is more competitive, it will be able to keep production levels high. Restructuring generally means reducing costs but could mean producing cars that consumers will be more likely to want. Cutting costs could be done by abandoning unprofitable models, specialising in production and gaining economies of scale, more automation or better skilled labour or management. Holden can also aim to produce cars it has an advantage in, which may be larger passenger vehicles, but with greater fuel economy than present. It is also aiming to maintain high production by asking for continuing assistance, which might help with research and development, capital investment or to support workers made redundant by technology.

e) Holden’s revenue would, in turn, be distributed widely throughout the local economies in which it operates. Labour would be a large part of Holden’s injections into the economy, and these wages would, in turn, be spent in local areas in hotels, cafes, schools and on holidays, creating and maintaining other jobs and income. Holden also has suppliers and dealers, which are often separate businesses with many of their own employees who depend on Holden, so it may count the income that these businesses generate. Holden would also spend a considerable amount in investment and would pay taxes. It is likely that Holden would calculate a multiplier effect (the more than proportional impact on national income) to its expenditure that would capture the flow on effects of its business operations. It is also likely that this very large sum of money is the result of many years of operations.
ECN315111 Economics

ASSESSMENT PANEL REPORT

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