Economics
Course Code: ECN315111

Section A

Question 1

Question 1 contained an unfortunate typographical error, resulting in candidates being asked to discuss ‘hidden employment’. As the course deals only with ‘hidden unemployment’ it was assumed that this was the intent of the question, and candidates who discussed this were able to gain marks for doing so.

Good answers in this section recognised the basic meaning of the three terms, namely that unemployment refers to persons who are not currently in paid employment but are seeking work, underemployment refers to persons working less than full time, and that hidden unemployment referred to persons not employed and no longer seeking work.

Better answers demonstrated deeper knowledge of each category and an understanding of how unemployment statistics are measured, and who is excluded/included. For example, these answers would reference the unemployed as being of working age (15+) and the underemployed as working at least one hour a week (thus not being counted on unemployment statistics) but having a desire to work more hours, yet no means to do so.

Question 2

This question required candidates to address both the concept of comparative advantage and also the role this plays in international trade.

Good answers here demonstrated an understanding of the principle that nations ought to produce those goods in which they incur the lowest opportunity cost. Key here also is the concept of using resources in the most efficient manner.

Generally this first part of the question was well answered.

Candidates were also to then explain how specialisation by nations in areas in which they have a Comparative Advantage creates a surplus for trading, and that the income generated through such trade can lead to purchases from other nations and an overall rise in the living standards of all trading nations.

Question 3

Good answers to this question demonstrated an understanding of the role that the foreign exchange market and the price mechanism play in determining the value of a nation’s currency.

Better answers provided specifics on what exactly an exchange rate is, being the value of one nation’s currency expressed in terms of another nation’s currency, and provided examples of how depreciation and/or appreciation of currency values were crucial to trade/international money flow.

Question 4

Candidates were expected to demonstrate the basic details of both Fiscal Policy and Monetary Policy, the manner in which each of these policies is enacted and the effect that each is expected to have on the Economy
after implementation. Candidates in general demonstrated a good understanding of the role of the Reserve Bank of Australia in using Monetary Policy and the Government in enacting Fiscal Policy.

Better answers identified how it is that Fiscal and Monetary Policy actually impact on Aggregate Demand/Economic Growth. Candidates on the whole were generally good at identifying how Government was able to use expansionary Fiscal Policy (decreasing taxes and/or increases in Government Spending) to manage recessions, and many candidates also chose to discuss the role of automatic stabilisers in recession management.

Question 5

Candidates who attempted this question generally had a good understanding that the Four Economic Questions are 1. What to Produce, 2. How to Produce, 3. How much to Produce and 4. How to Distribute Production. To simply provide this information was sufficient to pass.

Better answers were those who demonstrated knowledge of how the market system addresses these questions. In doing this candidates were able to discuss the role of the Price Mechanism, Freedom of Enterprise and Consumer Sovereignty’s impact on Production decisions, and the role that income plays in determining distribution.

Given that the question asked for candidates to discuss how the market system operates, it was not required, nor beneficial, for candidates to discuss the role of government.

Question 6

This question contained two distinct sections.

In the first section good answers demonstrated an understanding of the Law of Demand and the inverse relationship between price and the quantity demanded. Better answers recognised that the market demand curve is cumulative of all demand in a market by all consumers at varying price levels.

The second section was generally well answered and involved candidates describing not only the factor that influences demand, but how it does so. For example, discussing not only that ‘substitute goods’ impact on demand for the original good, but displaying a knowledge of how this is the case, e.g., ‘a rise in the price of a substitute good will cause demand for the original good to increase and shift the demand curve for the original good outwards’.

Question 7

Generally a well answered question.

Good answers demonstrated an understanding of the fundamental nature of quotas (limit on value or volume of imports) and tariffs (a tax on imported goods) and the protectionist reasoning for doing so (to preserve market share for domestic producers).

Better answers provided more specific detail, and often did so with the aid of diagrams for each of quotas and tariffs, with explanations accompanying them.
Question 8

Good answers recognized the nature of an externality being an unintended or insufficiently considered consequence of an action on a third party. Better answers narrowed this general view of externality to a more specific definition which recognised that externalities are costs and benefits that are not accounted for in the price mechanism and that parties negotiating a transaction do not take them into account when making a decision.

Better answers were also able to then extrapolate this understanding to show how the effect of second-hand smoke was an externality on the third party who is subjected to the immediate and lasting effects of smoke.

Question 9

Good answers here noted the correlation between price and quantity supplied and commented on the Law of Supply. Better answers noted that the market supply curve represents the sum of all quantities that producers are willing and able to supply in a market at varying price levels. Though not specifically required, the majority of candidates included a diagram of the supply curve.

In addition, better answers also noted the manner in which firms increase production (and therefore raise supply) in a market with increasing prices, and how this type of market also encourages the entry into the market of less efficient producers.

Section B

Question 10

Part (a) and (b) were generally well answered with most students showing a shift in the supply curve to the left. However many students included responses in part (a) that were more appropriate for part (b) and the other way around.

When discussing how market equilibrium was achieved, many answers identified a contraction along the demand curve, however better answers provided a more detailed explanation, these answers identified that after supply was reduced at Pe a shortage was created causing consumers to bid up the price and resulting in an expansion along the supply curve.

Question 11

Some students did not take sufficient care in reading part (a) and incorrectly gave unemployment rates rather than the number of unemployed.

Most students were able to correctly calculate the Australian unemployment rate of 6% versus 6.8% for Tasmania, and then go on to identify that Tasmanian had a larger percentage of part time workers compared to Australia. Better answers mentioned underemployment.

In part (c) marks were given when students indicated that there would be increased welfare spending but better answers mentioned State funds being spent on training, crime prevention and mental health services.

Question 12

Better answers gave more detail than just the fact that GDP was increasing while Interest rates were falling. Many students concluded that interest rates were set low in order to maintain consumption and investment and thus economic growth. Some identified changes as monetary policy decisions.
In part (c) most students discussed the fact that lower interest rates meant it was cheaper to borrow money and thus consumption increased, better answers added that servicing of existing loans was cheaper which in turn gave consumers an even greater amount for spending.

**Question 13**

The majority of candidates did very well on this question, however some students after giving a very good description of elasticity failed to specify that this example was relatively elastic. Students needed to use the total revenue method.

There were also a couple of students who incorrectly used the term unit elasticity.

**Question 14**

Most answers correctly identified that this was a price floor; better answers indicated that it was most probably a price floor as price ceilings are most effective when set below the market equilibrium. Students identified that it was to act as a minimum price in the market.

Almost all candidates identified that there would be a surplus of wool and better answers indicated this on their diagram or constructed an equation to represent the surplus.

**Question 15**

Nearly all students successfully calculated the aggregate demand as $850 billion but students need to be reminded to include units of measurement in their answers.

Most also correctly calculated the multiplier as 4.33.

All students seemed to have a reasonably good understanding of the multiplier effect.

**Question 16**

This question was answered very well by most students. Students explained the CPI as summarising price changes in a representative basket of consumer goods & services and recognised its role as a measure of the rate of inflation in Australia. The rate of inflation was generally calculated correctly as 4.03% for 2014. 4% was considered correct.

**Question 17**

Very few students chose to answer this question but those who attempted the question generally scored well. Some students failed to provide an interpretation of the graph. However, students were usually able to differentiate positive & negative balances and gave a variety of reasons which could account for changes in Australia’s balances on goods and services.

Section (b) was a source of confusion for students.

Any reason that caused trade balances to change as students stated was accepted.
Question 18

Students either scored very well or poorly on this question. Students who correctly identified that the market would produce imports of bananas in part (a) generally scored well. Students generally recognised that the demand curve shifts in part (b) and better answers went on to accurately describe the consequences that follow.

Section C

Question 19

Responses which defined and briefly discussed two types of unemployment (usually cyclical and structural) and then addressed the social and economic consequences tended to score best.

These responses were coherent, thorough and detailed.

A clear simple definition of unemployment was a good start. A definition of two types of unemployment was then required. Definitions including a very brief example were well rewarded.

Stronger candidates clearly identified which consequences of unemployment were economic (eg lower living standards, opportunity cost to economy, cost to government) and social (eg mental health issues, family breakdown and crime).

Question 20

This was a challenging question.

Students were expected to demonstrate their understanding of a budget deficit and national debt briefly. There were then three elements to a top answer. Why do governments run deficits (eg to stimulate a slow economy). How are deficits financed (eg borrowing or running down of saved surplus) and the economic consequences of these actions with a clear focus on economic problems.

Given the nature of the question a wide range of ideas were discussed and accepted such as international borrowing leading to increased CAD and the associated problems or future contractionary budgets trying to address deficit/debt leading to slower growth and increased unemployment.

Question 21

This was a complex question.

Good candidates very briefly defined globalisation. This was then followed by linking globalisation to each of growth, development, inequality and the environment. Candidates took very varied approaches to addressing problems related to growth and development. Some spent too long explaining the terms. Some clearly linked the opening up of trade to issues such as structural unemployment, whilst others combined growth and development. Some candidates were able to link globalisation to problems of inequality for example by referring to less inequality between economies but greater inequality within many economies. Many candidates were able to discuss problems related to the environment eg resource depletion.

A wide variety of responses were acceptable as there were many possible lines of response.
Section D

Question 22

This question was well answered and it is clear that students have been mindful to learn from past examiners’ comments regarding questions of a similar nature. The best students ensured that they adapted their prepared responses to the needs of the question – specifically addressing their answers to policy regarding demand pull inflation and unemployment.

The best answers provided precise definitions of the terms that were central to answering the question. Doing so sets up the focus and precision of the explanation that followed. In this respect it was helpful, when describing unemployment to make a distinction between structural and cyclical unemployment and explain that, monetary policy was mainly effective with cyclical unemployment.

Most candidates were able to identify that tightening monetary policy was an appropriate tool to deal with demand pull inflation. Better students explained the effect of raising interest rates on both consumption and, more importantly, investment (“the transition mechanism”) by explaining how it made servicing existing loans more expensive and taking out new loans less attractive, and saving more attractive.

Candidates then explained the opposite policy (loosening monetary policy) and its effect on unemployment. Candidates enhanced their marks if they pointed out:

• Monetary policy is regarded as more effective when dealing with inflation than unemployment (inflation targeting);
• It is an indirect policy and, for instance, in the case of loosening of policy, relies on business and consumers responding with greater spending; which may not occur in times of low confidence;
• It has lags;
• It is a ‘blunt instrument’, having equity effects.
• It has potential effects on exchange rates

Question 23

Any attempt to speculate on the economic effects of the policies in question, so long as it was linked to economic theory and was well explained, was rewarded.

The best answers outlined the role of government intervention in a mixed market economy and made the claim that any government intervention was aimed at eliminating a ‘market failure’. Such answers went on to suggest some market failures that patent laws and taxi regulations addressed. In the case of patents candidates suggested that ‘research and development into health outcomes’ might be a ‘merit good’ or a ‘public good’ and the competitive free market may underinvest in such goods. Patents by providing property rights in such research provided extra incentives to ensure the appropriate allocation of resources to these markets. Some candidates suggested economies of scale and ‘infant industry’ arguments.

With respect to the taxi industry, some candidates suggested that a purely competitive market would under allocate resources to ‘health and safety’ conditions and issues to do with qualifications and accountability of drivers. Some talked about the capacity to account for the environment in a regulated market. Some even talked about equity issues in both examples and suggested governments could impose such things as price ceilings in a regulated market. All approaches, if well argued, were rewarded. Many candidates talked about ‘protecting local jobs’ but rarely advanced economic arguments on the ‘pros and cons’ of this approach of protectionism.

Candidates were more successful at using their economics to address the second half of the question, pointing out the capacity of such market concentration to allow producers to restrict supply and increase price – pointing out that this leads to equity considerations and may inhibit technical efficiency, quality and innovation.
**Question 24**

This question really lent itself to the inclusion of supply and demand diagrams, yet many candidates either chose not to, or were unable to, construct accurate supply and demand diagrams to accompany their arguments. Those who included the diagrams found it much easier to analyse the situation comprehensively and precisely. Students are encouraged to develop a sense for when such diagrams are appropriate and to make sure that they are well practised at analysing the effects of the standard forms of government intervention described in the course, such as imposition of a sales tax. It would also have helped candidates to have included a precise definition of market failure in the form of ‘negative externalities’ as this would have lead on to a precise identification of the aims of government intervention in such circumstances, so enabling the candidates to better analyse the effects of each policy.

Students should also be mindful to use terminology precisely; in particular distinguishing between increases/decreases in demand and expansion/contraction in demand, for example. Most students identified that a sales tax would, ceteris paribus, cause a decrease in supply, upward pressure on prices, a contraction in demand causing a fall in the quantity sold. The best candidates analysed the effect of this on producers (worse off), consumers of cigarettes (worse off), government (tax revenue) and society (better off; lower external costs). Many candidates identified the equity concerns that might accompany the success of the campaign – lowering the standard of living of consumers and their families, often those who could least afford it. Too many candidates erroneously thought that a tax caused a decrease in demand rather than supply.

An education campaign, on the other hand, would cause a decrease in demand, downward pressure on price and a contraction of supply. This also decreased quantity sold, and producers were worse off, but those who continued to smoke were actually better off! It was also pointed out that this cost the government (compared to the tax which generated revenue for the government).

Better answers pointed out that demand for cigarettes was inelastic, suggesting that the effect on quantity sold for the tax option may be minimal (at least in the short run). This resulted in government revenue being relatively high and welfare effects of the tax relatively severe. These answers often suggested that, given this, education campaigns may be a more desirable option. Few people, however, drew a graph that illustrated inelastic demand.

**Section E**

**Question 25**

a) Better answers included a supply and demand diagram correctly indicating the situation before and after the removal of the tariff. Students showed how prices in China would fall, local production would contract and imports from Australia would expand.

b) Winners included Australian dairy farmers and Chinese consumers while losers included Chinese producers and the Chinese government in regards to their lost taxation revenue.

c) Better answers showed (and explained) how the increase in demand for Australian coal would cause an increase (shift to the right) in demand for Australian workers in the coal industry.

d) The removal of tariffs will result in lower prices for coal in China. This will encourage the use of coal in production which will therefore increase the greenhouse emissions in China.

e) Better answers included all relevant arguments for and against reducing trade barriers AND came to a conclusion, as the question asked.

**Question 26**

a) This question had a wide range of responses, with stronger answers recognising the impact on net exports due to falling prices of commodities. Responses were accepted from candidates that did not have a good understanding of the concept of the terms of trade, but who talked in general terms about the trade balance or exchange rates.
b) A range of responses to this question was accepted. Stronger responses had a title for their graph and clearly labelled them, and were better able to demonstrate that the increase in supply of credit resulted in a lower interest rate and expansion in demand for loans.

c) This question was well answered by most candidates. Strong responses again featured good labelling, with the demand curve for housing increasing and supply expanding. Many students observed that while sellers would benefit the most from house price increases, buyers were still benefitting from low interest rates.

d) Most candidates did a good job on this question, and interpreted the comment that further depreciation was necessary due to the advantages it would give to exporters and import competing businesses. Other student interpreted the question as meaning the fall in export prices would lead to decreased demand for Australian currency and therefore depreciation. Both responses were accepted, and some students gave both explanations.

e) Good responses explained that easing monetary policy meant reducing the cash rate, having an expansionary effect on aggregate demand via the transmission mechanism. Stronger responses mentioned two or more risks, such as a housing boom, risks of demand-pull inflation, the problem of the time lag, that further easing might not work due to poor consumer confidence.

Question 27

a) Under a regressive tax high income earners would pay a smaller proportion of their income as tax than would lower income earners. An excise duty is a regressive tax, especially as it is difficult to find substitutes for petrol.

b) Better answers explained how externalities are indirect costs that are not reflected in the operation of the price mechanism, and how it is often necessary for the government to intervene.

c) Better answers explained, with the use of a supply and demand diagram, how a tax on petrol will shift the supply curve to the left, resulting in a higher price and a lower quantity demanded.

d) As the demand is relatively inelastic, while the price will rise, the reduction in quantity demanded may be minimal. This will reduce the effectiveness of this policy.

e) Difficulties could include the point made in part d. Also there will be costs to consumers AND producers. Students discussed the inflationary effects of this. Political difficulties encountered with such a policy were discussed by many.