

**Economics ATAR 12 Exam Semester 2 2018**

**Marking Guide**

**Section 1 (24 marks)**

1 C

2 B

3 B

4 D

5 A

6 D

7 C

8 D

9 A

10 C

11 B

12 D

13 A

14 B

15 A

16 C

17 B

18 D

19 C

20 B

21 A

22 D

23 D

24 C

**Section 2 (36 marks)**

**Question 25 (12 marks)**

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| a. The role of the WTO is to promote free & open trade – negotiate trade disputes, promote trade liberalisation | 1-2 marks |
| b. Rising tariffs will lead to a fall in global economic growth because it will cause trade (exports & imports) to decline & costs to rise, reducing GDP growth | 1-2 marks |
| c. A tariff increases price of imports which reduces the qty of imports & enables domestic production to increase which increases domestic employment in the protected industry | 1-2 marks |
| d. The trade war results in escalating tariffs – this increases domestic costs, reducing efficiency & productivity. The AS curve will shift to the left increasing the price level, decreasing real GDP & employment. It is likely that net exports will actually fall due to retaliation which will mean that the AD curve may decrease causing a further fall in output & employment.  | 1-2 marks for effects on AS1-2 marks for AD effect1-2 marks for diagram |

**Question 26 (12 marks)**

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| a. i. $400 milliona. ii. $1000 million | 1 mark1 mark |
| b. mpc = 0.6 (change in C/change in real GDP = ) multiplier = 1/ (1- mpc) = 1/0.4 = 2.5 | 1 mark1 mark |
| c. If real GDP = $1400, then AE would equal $1240 – i.e. AE < GDPThis would cause an increase in inventories since spending is less than production. This would send a signal to firms to decrease production. As production falls, the economy moves down the AE line towards equilibrium at $1000, where spending matches production & there is no unplanned change to inventories. | 1 mark1-2 marks |
| d. A depreciation would lead to an increase in net exports since X prices would fall & import prices would rise. This would lead to an increase in aggregate expenditure (AE = C + I + G + NX).The AE curve would shift up, causing the equilibrium level of real GDP to increase. There would be a multiplier effect – real GDP would increase by more than the increase in net exports.Show change in the AE line & real GDP on the graph | 1 mark1 mark1 mark1 mark1 mark |

**Question 27 (12 marks)**

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| a. Growth in labour productivity increased from around 0.8% to 1.7%.**Note** most students will say from around 1% but this is incorrect (CD = 1% & mfp = -0.2, so LP = 0.8%). Need correct figures for 2 marks. LP increased because mfp increased significantly | 1-2 marks1 mark |
| b. **Capital deepening –** increase in labour productivity due to increasing capital per worker (increasing K/L ratio)**Multifactor productivity** – the increase in LP due to improvement in the quality of inputs – not the quantity; reflects improvements in technology, work practices, education & training | 1 mark1 mark |
| c. Labour productivity is a main driver of economic growth. There is a positive relationship between the two – as LP growth increases, economic growth increases (& vice versa). Use data from the graph.Say something about why – an increase in labour productivity means each worker can produce more resulting in an increase in the productive capacity of the economy. This means that the PPF shifts to the right &/or the AS curve shifts to the right resulting in economic growth | 1-2 marks1 mark |
| d. 2 marks for each policyCapital deepening – govt needs to increase capital per worker. This could be done by increasing govt spending on infrastructure, transport, communications etc. MFP – anything that can improve the quality of capital &/or labour e.g. govt could promote innovation through govt spending on research & development; increased spending on education & training to improve quality of labour | 1-2 marks 1-2 marks  |

**Section 3 (40 marks)**

**Answer TWO questions**

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

(a) Distinguish between the concepts of ‘absolute advantage’ and ‘comparative advantage’ and Discuss the main sources of comparative advantage. (8 marks)

(b) Explain, with the aid of a model, how a country can gain by exporting goods in which it has a comparative advantage and importing goods in which it has a comparative disadvantage. (12 marks)

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| a. Define absolute advantage – use an exampleDefine comparative advantage using opportunity cost – use an exampleOutline at least 3 main sources – different factor endowments such as natural resources (including farmland, minerals, energy resources, climate); differences in quantity & quality of labour & capital resources; differences in technology | 1-2 marks1-2 marks1-4 marks |
| b. Gains from exports – 6 marksBest to use D/S model – if a country has a comparative advantage then it has a lower opportunity cost than the rest of the world. This means that the world price is above the domestic price.At the higher world price, Qty demanded falls while qty supplied increases – the difference is exported. There is an increase in producer surplus which exceeds the decrease in consumer surplus – a net increase in total surplus.Gains from imports – 6 marksif a country has a comparative disadvantage then it has a higher opportunity cost than the rest of the world. This means that the world price is below the domestic price.At the lower world price, Qty demanded increases while qty supplied decreases – the difference is imported. There is an increase in consumer surplus which exceeds the decrease in producer surplus – a net increase in total surplus. | 1-4 marks for explanation1-2 marks for D/S model1-4 marks for explanation1-2 marks for D/S model |

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

 (a) The current account deficit fell from $22.6 billion in the December quarter 2015 to $10.5 billion in the March quarter 2018. Discuss the factors could have caused this significant change? (10 marks)

(b) Define the concept of foreign liabilities and explain the relationship between the current account outcome and foreign liabilities. (10 marks)

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| a. Discuss meaning of current account deficit – part of the balance of payments that records transactions in goods & services (trade balance) & transactions in income (income balance). Main reasons for fluctuations in the CAD are due to changes in the trade balance.Discuss factors that could have resulted in an increase in the trade balance (increase in trade surplus) or decrease in trade deficit). At least THREE* Increase in the terms of trade
* Depreciation in the AUD
* Higher growth from China increasing demand for exports
* Slower growth in Australia reducing spending on imports
* Decrease in investment in Australia reducing the I – S gap

Discuss factors that could have resulted in a decrease in the income deficit * lower world interest rates decreasing interest payments
* reduced foreign investment reducing outflows of income
 | 1-2 marks1-6 marks1-2 marks |
| b. Define foreign liabilities – what Australia owes to the rest of the world resulting from inflows of capital (foreign investment). It is the accumulation of financial account surpluses or the stock of foreign investment into Australia because of Australia’s I – S gap. Foreign liabilities consist of foreign debt & foreign equity – need to distinguish between the two.The CAD is equal to the I – S gap which means that Australia must rely on foreign investment to make up for the shortfall in savings. This is the financial account surplus. So each year the stock of foreign liabilities (foreign debt &/or foreign equity) increases.The servicing costs associated with foreign liabilities (interest payments & profits) is recorded in the income section of the current account.  | 1-6 marks1-4 marks |

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

(a) What is the business cycle? Describe the characteristics of the phases of the business cycle, referring to changes in at least three key economic indicators. (10 marks)

(b) Using the AD/AS model, explain how an increase in Australia’s terms of trade could cause a business cycle expansion. (10 marks)

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| a. What is the business cycle? – Describe the business cycle: fluctuations in economic activity over time, measured by real GDP; maybe draw diagramCharacteristics of the phases – expansion, peak, contraction, trough. Describe the features of each stageExplain the changes in at least 3 key indicators – e.g. inflation (procyclical), unemployment (countercyclical), participation rate (procyclical), current account balance (countercyclical), share prices, company profits, retail sales etc | 1-3 marks 1-4 marks1-3 marks |
| b. Define terms of trade – export price index / import price index; rise in ToT means XPI rises relative to the MPI (favourable movement)Explain how an **increase** in terms of trade can lead to a business cycle expansion - because it increases net exports & increases Australia’s real GDP & national income. Why? Australia exports commodities – higher prices for iron ore & coal boosts export income which directly increases net exports, stimulates investment In the mining sector, increases real income which increases consumption.Use of AD/AS model – increase in ToT will increase AD curve (shift to the right) because of increase in net Xs & investment but it will also increase AS because higher investment will increase capital stock which increases labour productivity. So both curves will shift to the right – strong business cycle expansion | 1-2 marks1-5 marks1-3 marks |

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

(a) Discuss the reasons why the government would use an expansionary fiscal policy stance and with the aid of a model, explain the impact of this stance on the level of economic activity. (12 marks)

(b) Explain the three time lags which occur in the use of economic policies and discuss how they differ between fiscal and monetary policy. (8 marks)

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| a. Discuss reason for an expansionary stance – economy is in a contraction or growing below trend growth (< 3 1/2%); unemployment is above the natural rate (>5%), Real GDP < potential GDP, inflation rate is below 2%; economy is in equilibrium to the left of LRAS curve. Expansionary stance is needed to increase real GDP, lower unemployment, shift the economy onto the LRAS curve. Use model e.g. AD/AS to show the economy in equilibrium below potential real GDP (Or AE model to show economy below full employment). Show the effect of expansionary stance in terms of shifting the curves.Expansionary fiscal stance – increasing G relative to T. This means increasing G and/or decreasing T; increasing the structural budget deficit or a decrease in the structural budget surplus.Increasing G will have a multiplier effect & increase the AD curve, increasing real GDP. Cutting income taxes will increase **Consumption** & increase AD. Cutting company tax will increase **Investment** & increase AD Cutting income tax will also increase AS due to increased **work effort**. Cutting company tax will increase investment which increases the **capital stock** & will also increase AS  | 1-4 marks1-2 marks1-6 marks(perhaps 4 marks for AD effects & 2 marks for AS effects) |
| b. Explain **THREE** time lags – recognition, decision & effect lagsRecognition lag is similar for bothDecision lag is much longer for fiscal policy than for monetary policy – explain whyEffect lag is much shorter for fiscal policy than for monetary policy – explain why | 1-3 marks1 mark1-2 marks1-2 marks |