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| Description: LowResASC MonoPos Vertical | ALL SAINTS’ COLLEGEEwing Avenue, Bull Creek, Western Australia |
| Year 12 ATAR Economics – Semester 1, 2020 Examination - SOLUTIONS |

**Section One: Multiple Choice Section (Ave 16.1/24 = 67%) 24% (24 marks)**

**1c 2b 3c 4a 5a 6b 7d 8b 9d 10c 11d 12b**

**13d 14c 15a 16c 17a 18b 19c 20a 21d 22d 23a 24b**



**General comments (exam ave 58.5%)**

* MC section general well done
* Data Qu 25 - best of the 3 qu’s. Part c) shift D curve left (to show depreciation)

Qu 25 c) note many different impacts on various types of businesses

* Data Qu 26 - BOP/CAD qu not well answered. Note calculation in part a). Part b) net foreign equity is negative! We (Aust) **owns more overseas assets** than own in Aust.

Part c) note the 3 cyclical factors and in d) Aust for the first time in 45 years had a current account surplus meaning we also had a capital and financial account deficit!

* Data Qu 27 – TOT qu not well answered. Note calculation of TOT (formula). In part b) must use term “FAVOURABLE” movement to describe the changes in the TOT due to rise in commodity prices. In part c) effects on the economy include depreciation of $A, decrease in trade balance (inc in CAD), fall in living standards….
* Essay Qu 28 a) factors include trade liberalisation, technology and MNC’s. Part B effects of globalisation must discuss both positives and negatives (some only mentions positives)
* Essay Qu 29 a) must accurately draw and label both a tariff and subsidy diagram. Subsidy diagram not well drawn by many students. Part b) must discuss understand impact on CS, PS and DWL. Market efficiency falls in both cases (tariffs & subsidies)
* Essay Qu 30 least popular of the 3 essay questions. Part a) FI…capital inflow/outflow usually inflow > outflow. Aust has a S/I gap. Difference btn direct and portfolio investment….direct > 10% control in a company… Benefits of FI are many and varied (worth 6 marks). Part b) FI recorded in the financial account. Usually inflow > outflow, but recently Aust has recorded a cap/financial account deficit! Interest, profit and dividends from this flows through the income section of the current account. Recently Aust had a current account surplus! Capital inflows increase liabilities, outflows add to stock of overseas assets Aust owns. Net foreign liabilities approx. 60% of GDP. Net foreign equity -10% is we own more than we owe!

**Section Two: Data Interpretation/Short response 36% (36 marks)**

**Question 25 (Ave 8.2/12 = 68%) (12 marks)**

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| **Description** | **Marks** |
| a. 1. Fall in Australia’s interest rate differential – state what this is: Aust i/rs fell relative to other major economies2. Decline in commodity prices (coronavirus on its own is not sufficient  | 11 |
| **Total** | **2** |

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| **Description** | **Marks** |
| b. The coronavirus would decrease production in China.This would decrease Chinese demand for major commodities such as iron ore, coal & oil reducing their prices | 11 |
| **Total** | **2** |

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| **Description** | **Marks** |
| c. Choose ONE reason: 2 marks for explanation / 2 marks for model1. Fall in i/r differential: This will cause a decrease in D($A) - less capital inflow into Australia & an increase in S($A) - more capital outflow. Students need only to explain one of these to earn the 2 marksUse correctly labelled model to show either a decrease in D($A) or an increase in S($A) OR2. Fall in commodity pricesThis will cause a decrease in D($A) – lower commodity prices would decrease the value of Aust’s exportsUse correctly labelled model to show decrease in D($A) | 1-21-21-21-2 |
| **Total** | **4** |

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| **Description** | **Marks** |
| d. Household sector – depreciation would have a negative effect since households as consumers of imported goods & services will have to pay higher prices: imported appliances, overseas travel, petrol etcBusiness sector – businesses that sell imported goods will be negatively affected since their prices will rise reducing their competitivenessbusinesses that export will be positively affected since their prices will fall to overseas buyers boosting their competitivenessbusiness costs for all firms will rise due to higher input costs – costs of fuel, capital equipment, motor vehicles, computers etc… | 1111 |
| **Total** | **4** |

**Question 26 (Ave 5/12 = 42%) (12 marks)**

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| **Description** | **Marks** |
| a. i. Net income = -$13,210 million NFL = $975,989 millionii. NFL as a percent of GDP have decreased Deceased | 111 |
| **Total** | **3** |

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| **Description** | **Marks** |
| b. Aust’s net foreign equity liability is now negative which means it is now a foreign asset – Aust owns more foreign assets than foreign countries own of Aust’s assetsAust’s net foreign equity asset position has increased from $104bn to $187bn due to Aust investors (superannuation funds) purchasing overseas shares, property, financial assets | 11 |
| **Total** | **2** |

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| **Description** | **Marks** |
| c. Aust’s current account changed from a deficit of $20bn to a surplus of nearly $8bn (an increase of $28bn)Key understanding is that the change was due to the massive increase in the trade balance – basically cyclical factors.Any **THREE** cyclical factors:1) growth in volume of exports – increased demand for mining exports from China (China’s business cycle) 2) increase in prices of exports – increase in commodity prices (rise in terms of trade)3) depreciation of $A increasing net Xs 4) fall in consumption & investment in Aust has reduced demand for imports resulting in higher net exports (Aust’s business cycle) |  1 0-3 |
| **Total** | **4** |

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| **Description** | **Marks** |
| d. This is more difficult (most students will get 1 or 2 marks)A current account surplus means that Aust’s usual I – S gap has reversed into a S – I gap – i.e. Aust’s savings now exceed its investment. This means that the usual financial account surplus becomes a deficit and there is net capital outflow instead of net capital inflowIf the current account surplus persists then Aust’s net foreign liabilities will start to decrease & the net income deficit will also begin to decrease | 111 |
| **Total** | **3** |

**Question 27 (Ave 6.1/12 = 50%) (12 marks)**

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| **Description** | **Marks** |
| a. i. XPI = approx 118-119; MPI = approx 108 ToT = approx 109-110ii. March 2016iii. Any 2: Dec 2016; Jun 2017; Mar 2018 | 111 |
| **Total** | **3** |

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| **Description** | **Marks** |
| b. There was a rise (favourable movement) in the terms of tradeThis was due to the XPI increasing faster than the MPI Reason: rise in commodity prices | 111 |
| **Total** | **3** |

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| **Description** | **Marks** |
| c. 2 marks for effect of coronavirus on ToT – the ToT would decrease (unfavourable movement) since the XPI would fall relative to the import price index4 marks for ANY 2 effects1) Aust dollar: A fall in the ToT would depreciate the $A because relatively lower XPI would decrease the value of exports decreasing the D($A)2) Trade balance: A fall in the ToT would decrease the trade balance because the value of exports would fall relative to the value of imports 3) National income/Living standards: A fall in the ToT would decrease Aust living standards because national income decreases & we can now purchase less imports with a given volume of exports |  1-21-21-21-2 |
| **Total** | **6** |

**Section Three: Extended Response 40% (40 marks)**

**Question 28 (Ave 11.4/20 = 57%) (20 marks)**

(a) Discuss the factors that have facilitated the process of globalisation and the reasons for the contemporary/current slowdown in world trade. (12 marks)

(b) Evaluate the economic effects of globalisation. (8 marks)

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| **Description** | **Marks** |
| (a) Define globalisationFactors facilitating globalisation: 1-6 marks (any 3 factors x 2 marks)The WTO & trade liberalisation – the WTO has over time facilitated the reduction in trade barriers (tariffs & other forms of protection) which has increased the volume of world trade.Technology – advances in transport, communications & ICT have enabled the rapid growth in goods & services trade.Growth of ‘global value chains’ or vertical specialisation – production is broken into stages & completed in different countries encouraging interconnectedness between countries). This may be combined with growth of multinationals.Reasons for contemporary/current slowdown: 1-4 marks (2/3 reasons)Many countries have adopted more protectionist policies which has slowed the growth of world trade. Similarly many countries are placing restrictions on immigration The world’s two largest economies (US & China) have been engaged in a trade war which has had a negative effect on world trade.Some will mention the current crisis which will probably result in a world recession & decrease global trade (eg Coronavirus) |  1-21-21-21-21-4  |
| **Total** | **12** |

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| **Description** | **Marks** |
| (b) Evaluate means to discuss both positive & negative effectsPositive effects (benefits): 1-5 marksOver the past 100 years, globalisation has been one of the most important causes of the rapid growth in real incomes & living stds across the global community – increased consumption; greater choice of goods & services for consumers; lower prices; increased competition & efficiency; higher rates of economic growth; quicker uptake of new technology; reduction in global povertyNegative effects (costs): 1-3 marksIncreases interdependence between economies which can cause a negative shock in one economy to affect other economies e.g. China & AustraliaSpecialisation may result in increased volatility in the form of terms of trade shocks e.g. Aust subject to large swings in its terms of tradeGreater structural change – which can cause disruption in contracting industries e.g. higher unemployment |  1-51-3  |
| **Total** | **8** |

**Question 29 (Ave 11.9/20 = 60%) (20 marks)**

(a) Use a demand/supply model to explain and demonstrate the operation of a tariff and a subsidy as forms of protection. (12 marks)

(b) Compare the effects of a tariff and a subsidy on trade and market efficiency. (8 marks)

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| **Description** | **Marks** |
| a) Tariff – 6 marks2 marks for explanation of a tariff - tax placed in imports which raises the price, reduces qty consumed, increases domestic production, raises govt revenue1 mark to state how the tariff ‘protects’ the domestic industry – show that imports are squeezed, domestic producers gain a larger market share 3 marks for a correctly labelled model Subsidy – 6 marks 2 marks for explanation of a subsidy – govt grant given to domestic producers which increases domestic S curve to the right increasing domestic production with no change in price1 mark to state how the subsidy ‘protects’ the domestic industry – show that imports are squeezed, domestic producers gain a larger market share 3 marks for a correctly labelled model  |    1-211-31-211-3 |
| **Total** | **12** |

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| **Description** | **Marks** |
| b) Note: many students will get less than 50% for this question – it is more difficult than it looks. An answer that says a tariff (or subsidy) is inefficient because it causes a DWL is only worth 1 mark4 marks for effects of a tariff – can refer to the initial diagram to explain effects – must show on the model & explain * increase in producer surplus
* decrease in consumer surplus
* deadweight loss.
* a tariff decreases market efficiency because the loss in CS > gain in PS + govt revenue

4 marks for effects of subsidy – can refer to the initial diagram to explain effects – must show on the model & explain * increase in producer surplus
* no change in consumer surplus
* cost of subsidy
* a tariff decreases market efficiency because the cost of the subsidy > gain in PS
 | 1111 1 111 |
| **Total** | **8** |

**Qu 29 models**

**Tariff**

A tariff will cause the price to rise from 0W to 0T – increasing domestic production from q1 to q3 & decreasing qty consumed from q2 to q4. Imports are reduced to q3q4.

The tariff causes a large decrease in consumer surplus = (a+b+c+d).

Producer surplus increases by (a) while govt revenue increases by (c).

Areas (b & d) represent the net decrease in total surplus – the deadweight loss.

A tariff is inefficient.

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**Subsidy**

**Subsidy**

Must show world price below domestic equilibrium

Subsidy shifts S curve to right – increasing domestic production to q3 & reducing imports to q3q2.

While there is no welfare effect on consumers, producer surplus increases by WDAC, however cost of subsidy is WDAB which is greater than the increase in producer surplus. This is why a subsidy is inefficient – it creates a DWL (ABC)

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**Question 30 (Ave 11/20 = 55%) (20 marks)**

(a) Discuss the concept of foreign investment and the benefits of foreign direct investment to the Australian economy. (12 marks)

(b) Explain the relationship between foreign investment, the balance of payments and foreign liabilities. (8 marks)

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| **Description** | **Marks** |
| 1) Concept of foreign investment: 1-4 marks Meaning of foreign investment – refers to the financial/capital flows from one country to another– foreign residents invest into Australia (capital inflow) & Australian residents invest into overseas countries (capital outflow). Usually for Australia capital inflow > capital outflow.Due to Australia’s investment-savings gap (I - S). Australia’s investment needs have traditionally been much greater than our savings which has resulted in Australia drawing on foreign savings (foreign investment) to fill the gap. Aust’s relatively small population does not generate enough savings to finance its investment needs – e.g. the mining sector. Direct & portfolio – Directis when a foreign firm establishes a new business or acquires 10 per cent or more of an Australian enterprise. It is more long term & stable. Portfoliorefers to the purchase of Australian securities (such as shares or bonds) which do not offer the investor any control over the operation of the enterprise (<10%). It is more short term & speculative2) Benefits of FDI: 1-6 marks – should discuss at least four* Foreign investment provides access to capital to supplement our domestic savings – it accounts for around 12% of our investment needs
* Foreign investment stimulates economic activity and creates jobs – a 10% increase in FI leads to a 1% increase in real GDP
* Foreign capital has enabled Australians to enjoy higher rates of economic growth and standards of living
* Foreign investment has supported the growth of successive Australian industries such as mining, agriculture, financial services
* Foreign direct investment brings technological improvements boosting productivity growth
 |   1-21-21-21-6  |
| **Total** | **12** |

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| **Description** | **Marks** |
| 4 marks – foreign investment & BoPForeign investment flows are recorded in the financial account: normally Aust records a financial account surplus since capital inflow exceeds capital outflow but in the last few quarters Aust has recorded a financial account deficit.The income transactions associated with foreign investment – such as interest payments & dividends/profits are recorded in the current account. Australia records an income deficit because income payments exceed income receipts4 marks – foreign investment & foreign liabilitiesCapital inflow adds to Aust’s stock of foreign liabilities which is what Aust owes to the rest of the world. Capital outflow adds to the stock of Aust’s foreign assets which is what Aust owns from the rest of the world. Because Aust’s foreign liabs exceed its foreign assets, Aust has a net foreign liability position = around 50% of GDP.Australia’s net foreign liabilities comprise net foreign debt (60% of GDP) & net foreign equity (-10% of GDP). Aust has preferred to borrow funds rather than sell equity which is why all of Aust’s net foreign liabilities are in the form of foreign debt. In fact Aus now has a net foreign equity asset position. | 1-21-21-21-2  |
| **Total** | **8** |