

**Economics Unit 3 Exam Semester 1 2019**

**Marking Guide**

**Section 1 (24 marks)**

1 C

2 B

3 C

4 A

5 D

6 B

7 A

8 B

9 A

10 D

11 C

12 D

13 C

14 A

15 B

16 C

17 D

18 D

19 C

20 B

21 D

22 A

23 A

24 B

**Section 2 (36 marks)**

**Question 25 (12 marks)**

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| a. i. The largest ever trade surplus for a calendar year OR record two way trade in goods & services  ii. The sum of both exports & imports  iii. Iron ore & coal (must have both) | 1 mark  1 mark  1 mark |
| b. Identify that there was a large increase in the trade balance (trade surplus increased).  This would have caused the current account deficit to decrease (ceteris paribus)  This would have caused the financial account balance (surplus) to also decrease, since the CAD & the FAS must sum to zero | 1 mark  1 mark  1 mark |
| c. i. During 2018 the AUD depreciated – this would have caused net exports to increase since export prices would have fallen, increasing qty of exports while import prices would have risen, reducing purchases of imports.  ii. If the terms of trade increased then this means that export prices have risen relative to import prices which will increase export revenue (assuming no change in volumes) and this will increase the trade surplus  iii. Recent FTAs with China & Japan would have boosted trade with these countries by reducing trade barriers (both exports & imports), increasing the volume of trade – net effect is likely to be an increase in net exports | 1-2 marks  1-2 marks  1-2 marks |

**Question 26 (12 marks)**

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| a. i. Global trade growth (chart D) decreased from over 5% in 2017 to less than 4% in 2018  The index of new export orders (chart A) declined from a peak of around 54 in 2017 to around 50 in 2018  Note: Charts B & C are not relevant | 1 mark  1 mark |
| b. A trade war occurs when one country places tariffs (protection) on imports from a given country & then that country retaliates  The evidence is shown in chart C – the share of imports affected by new tariffs is much higher for US & China than the ROW | 1-2 marks  1 mark |
| c. Any three arguments (reasons) – 1 mark each  1. To increase employment in a particular industry e.g. steel industry  2. To reduce the US trade deficit with China  3. To reduce suspected ‘dumping’ from Chinese firms  4. For national security  Note – infant industry & diversification arguments are not relevant reasons in the case of a trade war | 1 mark  1 mark  1 mark |
| d. In the case of the importing country, tariffs increase the price & reduce consumption. Tariffs will also increase the costs of domestic firms relying on imported inputs. Tariffs reduce economic efficiency.  The exporting country’s exports will be less competitive, reducing its export sales which will have a negative effect on its employment & national income (GDP) | 1-2 marks  1-2 marks |

**Question 27 (12 marks)**

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| a. i. Trade weighted index (TWI) – an index showing the value of a country's currency in relation to a basket of currencies of its main trading partners (weighted according to volume of trade).  ii. Interest rate differential – the difference between Australia’s interest rates & interest rates of another country (e.g. the US) | 1 mark  1 mark |
| b. First half of 2013: AUD = US$1.05  TWI = 128 (allow small margin)  Reason:Either the i/r differential was at its highest value or the commodity price index was also at its highest value | 1 mark  1 mark  1 mark |
| c. There appears to be a positive (direct) relationship between changes in commodity prices & the AUD – when the commodity price index rises (falls), the AUD rises (falls).  Between 2013 – 2015, the index of CPs decreased & so did the AUD; during 2016, the index of CPs increased & the AUD appreciated.  Australia’s largest export category is resources – iron ore, coal, natural gas, gold – which means that when prices increase (decrease), the value of Aust’s resource exports will increase (decrease), increasing (decreasing) the demand for AUD. | 1 mark  1 mark  1-2 marks |
| d. The factor responsible for the change in 2018 was the i/r differential, not commodity prices  During 2018, both the AUD & the i/r differential decreased, while the commodity price index increased  When the i/r differential decreases, there is less capital inflow into Australia which reduces the demand for AUD & results in the AUD depreciating. | 1 mark  1 mark  1 mark |

**Section 3 (40 marks)**

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

(a) Outline the role of the World Trade Organisation (WTO) in facilitating globalisation and evaluate the economic effects of globalisation. (12 marks)

(b) Discuss the ways in which the Australian economy is dependent on the global economy. (8 marks)

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| a. Role of WTO – 6 marks  Should define globalisation - is the integration of national economies through trade, foreign investment, migration, and technology  WTO – organisation dealing with the rules of trade between nations. It’s an organisation for liberalising trade; it’s a forum for governments to negotiate trade agreements and It’s a place for them to settle trade disputes, involving dumping, use of subsidies & tariffs. Overall aim is to promote free trade by negotiating the reduction or removal of trade barriers (multilateralism)  Better students will mention the two key principles – the ‘most favoured’ nation principle & the ‘national treatment’ principle.  Evaluate economic effects – 6 marks  Discuss both positive & negative effects – but net effect has been positive  Positives – Increased trade has reduced prices, provided greater choice of goods & services, higher consumption, increased living stds, promoted competition & economic growth, increased access to investment funds  Negatives – created structural change resulting in structural unemployment in less competitive industries, loss of local culture, increased inequality | 1 mark  1-4 marks  1 mark  1 mark  1-3 marks  1-2 marks |
| b. Discuss 3 factors – allocate more marks to discussion of trade & foreign investment (3 marks each) & less to either tourism & immigration (2 marks)  *i. Trade*  *Discuss both exports & imports – some knowledge about the composition & direction of Australia’s trade. Total trade is around 45% of GDP. Much of our export income comes from the sale of resources, but services such as education & tourism are also important. Aust industry depends on the import of capital & intermediate goods. Some may focus on discussion of FTAs which is fine*  *ii. Foreign investment – Aust has an I – S gap & so relies on foreign investment to fund our shortfall in savings needs. Inflows of foreign funds enable increased spending on housing, construction, infrastructure, industry expansion etc.*  *iii. Tourism – Aust tourists travelling overseas is our main import but inbound tourism is also significant (5th largest export) OR*  *iv. Immigration – immigration can add to our skilled labour force, which is an important source of economic growth* | 1-3 marks  1-3 marks  1-2 marks |

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

(a) Demonstrate the theory of comparative advantage using the production possibility frontier model and the concept of opportunity cost. (12 marks)

(b) Using a model, evaluate the efficiency of a subsidy as a form of protection to an import competing industry. (8 marks)

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| a. Two correctly labelled PPFs showing 2 countries/2 goods (see example below)  Define comparative advantage  Use opportunity cost to determine which country has comparative advantage & therefore who will specialise in which good  Need to demonstrate that after trade, both countries will gain – easiest to show this with a consumption possibility frontier based on opportunity cost ratios (e.g. see p. 32 P&K)  OR Use a table showing consumption before & after trade | 1-2 marks  1 mark  1-4 marks  1-5 marks |
| b. Suggested mark split: explanation – 5 marks / model – 3 marks  i. Explain the nature of a subsidy and how it works as a form of protection – govt payment to import competing industry to increase domestic production & reduce imports.  Diagram to show effect of subsidy – see below  State that a subsidy is inefficient  Why? Because the cost of the subsidy exceeds the benefit to domestic producers – the subsidy creates a DWL | 1-2 marks  1-3 marks  1 mark  1-2 marks |

**Example of PPFs** – in this example, Australia has a lower o.c. in producing suits & a higher o.c. in producing computers compared with Japan. So Aust has a comp. advantage in producing suits while japan has a comp. advantage in producing computers

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**Subsidy**

Must show world price below domestic equilibrium

Subsidy shifts S curve to right – increasing domestic qty 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 PS. This is why subsidy is inefficient – it creates a DWL (ABC)

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

(a) Describe the main components of Australia’s current account. (8 marks)

(b) Explain the effects of each of the following on Australia’s current account deficit:

i. a decrease in Australia’s economic growth

ii. an increase in foreign investment

iii. an increase in the TWI (12 marks)

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| a. The current account records transactions in goods, services & income  i. Goods – exports (iron ore, coal, natural gas, gold, metals); imports (motor vehicles, petrol, consumer goods, machinery)  ii. Services – exports (education, overseas tourists, professional services); imports (Aust tourists, transport)  The trade balance is the sum of both goods & services trade – which can swing from deficit to surplus  iii. Income –primary income is largest & most important which includes compensation of employees & investment income (dividends & interest). Australia always records a large net income deficit due to its large income payments related to foreign investment. | 1 mark    1-2 marks  1-2 marks  1-3 marks |
| b. 3 factors x 4 marks  i. A decrease in Australia’s economic growth will decrease the CAD (ceteris paribus)  A fall in economic growth will reduce spending in the economy (both consumption & investment). This will reduce the demand for imports and cause the trade balance to increase thereby reducing the CAD (ceteris paribus)  ii. An increase in foreign investment will increase the CAD (ceteris paribus).  An increase in foreign investment will increase the income payments (both dividends & interest) associated with the foreign investment. These payments are recorded in the current account which will increase the income deficit & therefore the CAD.  iii. An increase in the TWI will increase the CAD (ceteris paribus)  A rise in the TWI means that the AUD has appreciated, on average, against the currencies of its major trading partners. This will decrease the competitiveness of Aust’s goods & services to overseas buyers, reducing exports. At the same time, an appreciation reduces the price of imports, increasing imports. This will reduce the trade balance and increase the CAD. | 1 mark  1-3 marks  1 mark  1-3 marks  1 mark  1-3 marks |

**Question 31 (20 marks)**

(a) Distinguish between Australia’s foreign assets and foreign liabilities and outline the recent trends in Australia’s net foreign liabilities. (12 marks)

(b) Australia’s net foreign debt has increased to around $1,100bn. Is this a cause for concern? Give reasons to support your answer. (8 marks)

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| a. Foreign liabilities (equity & debt) is the stock of foreign investment into Australia – what Australia ‘owes’ to the rest of the world. Foreign assets (equity & debt) is the stock of Australia’s investment abroad – what Australia ‘owns’. Australia’s total foreign liabilities is around $3,600bn and is much greater than Australia’s foreign assets of $2,600bn. This means that Aust’s net foreign liabilities is around $1,000bn.  Australia’s net foreign liabilities is divided into net foreign debt and net foreign equity. Foreign debt is the amount borrowed from non-residents by residents of Australia. Net foreign debt is around $1100bn. Foreign equity is the extent to which foreign residents own Australian assets. Australia's net foreign equity is around -$100bn – which means that Australian has a positive net equity asset position (we own more overseas assets than the world owns of our assets!).  While net foreign liabilities increases each year in dollar terms, it has remained fairly stable over the past decade when measured as a per cent of GDP – fluctuating between 50% & 60%. In 2018 it was 52%. Net foreign debt was equal to 57% of GDP while net foreign equity was around -5%. The main change has been that net foreign equity has shifted from a liability to an asset position due to the growth of Aust’s superannuation funds investing in overseas assets. | 1-4 marks    1-4 marks  1-4 marks |
| b. Australia has a high level of foreign debt because of Australia’s investment/savings (I – S) gap. Australia records current account deficits/financial account surpluses because its investment is greater than its savings. The accumulation of CADs represents the stock of net foreign liabilities. Foreign debt is now larger than all of net foreign liabilities because Australia’s net foreign ­equity position is positive.  State whether it is or isn’t a concern  Reasons/arguments (1 – 4 marks)  Can provide reasons for either position or discuss both – should discuss at least 3 reasons for 4 marks  Reasons why it is not a problem – this is the consensus view  While the level of net foreign debt has increased to over $1,000bn, when measured as a per cent of GDP it has increased more slowly from around 50% of GDP in 2010 to 57% in 2018.  While foreign debt has increased over time, Australia’s total assets have risen at a faster rate, increasing Aust’s net worth  Foreign debt enables Aust to have a higher level of investment which increases GDP, national income & therefore living stds  Most of Aust’s net foreign debt is private debt (around 75%) rather than public (govt) debt. The private sector prefers to borrow from overseas rather than sell assets to obtain funds which increases foreign debt.  OR Reasons why it is a problem  High level of foreign debt may lead to downgrading of Aust’s credit rating by international agencies – this may make it more difficult for new borrowers to access funds  A rise in world interest rates will increase the interest payments which will further increase Aust’s net income deficit  If borrowing is not used productively then national wealth may decline over time  Some may argue that a depreciation in the $AUD will increase the value of foreign debt but this is not necessarily true given that most of Aust’s foreign debt is in $AUD and not affected by changes in the exchange rate | 1-3 marks  1 mark  1-4 marks |