

**Examination, 2018**

**Question/Answer Booklet**

ECONOMICS Unit 3 Semester 1, 2018

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**Student Number: In figures**

**In words:**

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**Time allowed for this paper**

Reading time before commencing work: ten minutes

Working time for paper: three hours

**Materials required/recommended for this paper**

***To be provided by the supervisor***

This Question/Answer Booklet

Multiple-choice Answer Sheet

***To be provided by the candidate***

Standard items: pens (blue/black preferred), pencils (including coloured), sharpener,

correction fluid/tape, eraser, ruler, highlighters

Special items: non-programmable calculators approved for use in the WACE examinations

**Important note to candidates**

No other items may be taken into the examination room. It is **your** responsibility to ensure that you do not have any unauthorised material. If you have any unauthorised material with you, hand it to the supervisor **before** reading any further.

**Structure of this paper**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Section | Number of questions available | Number of questions to be answered | Suggested working time (minutes) | Marks available | Percentage of examination |
| Section One:  Multiple-choice | 24 | 24 | 30 | 24 | 24 |
| Section Two:  Data interpretation / Short response | 3 | 3 | 70 | 36 | 36 |
| Section Three:  Extended response | 4 | 2 | 80 | 40 | 40 |
|  |  |  |  | **Total:** | 100 |

**Instructions to candidates**

1. Answer the questions according to the following instructions.

**Section One**: Answer all questions on the separate Multiple-choice Answer Sheet provided. For each question shade the box to indicate your answer. Use only a blue or black pen to shade the boxes. If you make a mistake, place a cross through that square, then shade your new answer. Do not erase or use correction fluid/tape. Marks will not be deducted for incorrect answers. No marks will be given if more than one answer is completed for any question.

**Section Two and Three**: Write answers your answers in this Question/Answer booklet.

2. You must be careful to confine your responses to the specific questions asked and to follow any instructions that are specific to a particular question.

3. Supplementary pages for the use of planning/continuing your answer to a question have been provided at the end of this Question/Answer booklet. If you use these pages to continue an answer, indicate at the original answer where the answer is continued, i.e. give the page number.

**Section One: Multiple Choice (24 Marks)**

This section has **24** questions. Answer **all** questions on the separate Multiple-choice Sheet.

For each question shade the box to indicate your answer. Use only a blue or black pen to shade the boxes. If you make a mistake, place a cross through that square, then shade your new answer. Do not erase or use correction fluid/tape. Marks will not be deducted for incorrect answers. No marks will be given if more than one answer is completed for any question.

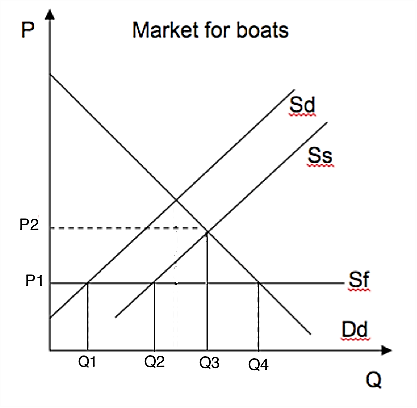
Suggested working time: **30** minutes.

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1. What are the two key economic indicators that economists use to measure the extent of globalisation?
2. GDP per capita and foreign investment flows.
3. Current account balances and comparative advantage.
4. Trade intensity and financial investment flows.
5. Free trade agreements and immigration flows.
6. Other things being equal, Australia’s international competitiveness would be improved by an increase in which of the following?
7. Australian inflation.
8. Investment in Australia’s capital infrastructure.
9. Australian government spending.
10. The value of the Australian dollar.
11. Research has shown that those economies that increase their trade openness over time experience
12. faster rates of economic growth.
13. slower rates of economic growth.
14. more favourable terms of trade.
15. lower trade deficits.
16. Australia put a tariff on all goods imported from overseas to increase the nation’s revenue and employment then
17. the countries total output would definitely increase.
18. workers with jobs in firms replacing imports would earn a higher income.
19. the standard of living within Australia would decrease.
20. the prices of goods imported into Australia would fall.

Question 5 refers to the table below which shows the production possibilities of Korea and Australia in producing cameras and televisions.

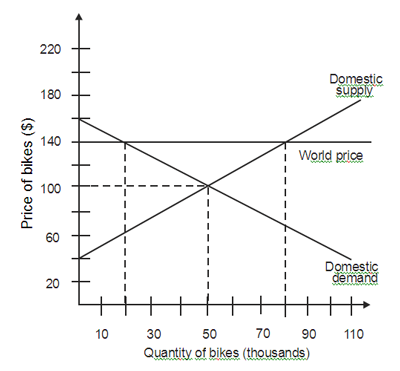
|  |  |  |
| --- | --- | --- |
|  | Cameras (units) | Televisions (units) |
| Korea | 50 | 40 |
| Australia | 10 | 20 |

1. Which of the following statements is correct?
2. Australia should export cameras and import televisions.
3. Australia does not have an absolute advantage in either good and should therefore import both goods.
4. Australia should export televisions and import cameras.
5. An acceptable terms of trade is 1 camera for 1 television.
6. **This question refers to the diagram below that shows the impact of the imposition of a subsidy on the domestic market for boats.

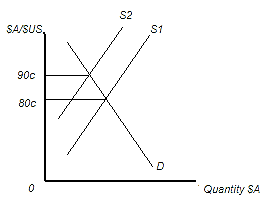
Pw

With a subsidy applied, the market price for boats is \_\_\_\_\_\_\_\_\_\_\_\_\_ and the amount of imports is \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.

1. P2; Q2Q4
2. P1; Q1Q3
3. P1; Q2Q4
4. P2; Q3Q4
5. Which of the following is a direct source of a country’s comparative advantage?
6. The domestic economic growth rate.
7. Wage rates.
8. Government budget policy.
9. Interest rates.
10. The government pays a subsidy to an industry competing with imports. As a result, consumer surplus \_\_\_\_\_\_\_ , producer surplus \_\_\_\_\_\_\_ and total surplus \_\_\_\_\_\_\_ .
11. does not change, increases, increases
12. decreases, increases, does not change
13. decreases, increases, decreases
14. does not change, increases, decreases
15. Use the diagram below showing the market for bikes.

 In an open economy, how many bikes will this country export?

1. 20,000
2. 50,000
3. 60,000
4. 80,000
5. The main reason for Australia’s relatively low trade intensity ( is:
6. its relatively high level of economic development (high GDP/capita).
7. its relatively small population compared with the major developed economies.
8. its protectionist trade policy stance resulting in a closed economy.
9. its geographic isolation from the large economies of Western Europe.
10. Australia’s most important two-way trade partners are
11. China, South Korea and India.
12. China, Japan and India.
13. China, Japan and USA.
14. Japan, China and South Korea.
15. What indicator measures trade openness of an economy?
16. Terms of Trade Index.
17. Trade Weighted Index.
18. Trade Intensity Ratio.
19. Capital Output Ratio.

1. When an Australian exporter sells software to France and uses the proceeds to buy shares in a French company, Australia exports \_\_\_\_\_\_\_ and there is a capital \_\_\_\_\_\_\_ Australia.
2. increase; outflow from
3. increase; inflow to
4. do not change; inflow to
5. decrease; outflow from
6. The part of the balance of payments that records transactions leading to a change of ownership of commodities, or a flow of income, is known as
7. the capital account.
8. the current account.
9. the balance on merchandise trade.
10. the financial account.
11. In the capital and financial account, the largest category of international transactions is
12. net interest.
13. foreign investment in Australia.
14. government borrowing.
15. exports and imports.
16. Which one of the following would be recorded as a debit in Australia’s balance of payments in the current account?
17. The sale of Australian wool to Italy.
18. An increase in the number of foreign tourists visiting Australia.
19. Interest paid on Australian Government bonds to overseas investors.
20. A Chinese company purchasing a farming property in rural Australia.
21. A decline in Australia’s terms of trade would most likely
22. decrease Australia’s trade balance and increase the value of the Australian dollar.
23. decrease Australia’s trade balance and decrease the value of the Australian dollar.
24. increase Australia’s trade balance and decrease the value of the Australian dollar.
25. increase Australia’s trade balance and increase the value of the Australian dollar.
26. In 2019, if one US dollar buys 1.25 Australian dollars, and in 2020 one Australian dollar buys 0.75 US dollars, which of the following statements is most correct?
27. There is no change in the exchange rate between 2019 and 2020.
28. Australian exports are less expensive for US buyers in 2020 compared to 2019.
29. Goods imported from the US are more expensive for Australian buyers in 2019 compared to 2020.
30. For US investors, Australian assets are more expensive to buy in 2020 compared to 2019.
31. The Trade Weighted Index (TWI) measures
32. the price of Australian exports relative to the price of Australian imports.
33. the total value to Australian exports relative to the total value of Australian imports.
34. Australia’s inflation rate relative to the weighted average of inflation rates of our major trading partners.
35. the value of Australian dollar relative to the value of a basket of currencies of our major trading partners.
36. The movement shown in the model below may have been due to
37. an increase in the domestic interest rate.
38. a downturn in the Australian economy.
39. an increase in Australia’s terms of trade.
40. a decrease in Australia’s national savings.
41. Which of the following is regarded as portfolio investment into Australia?
42. Purchase of 25 per cent of shares in a Japanese firm by an Australian firm.
43. Purchase of 8 per cent shares in a Japanese firm by an Australian firm.
44. Purchase of 8 per cent shares in an Australian firm by a Japanese firm.
45. Purchase of 25 per cent shares in an Australian firm by a Japanese firm.
46. The table below shows hypothetical data for the Australian economy.

|  |  |
| --- | --- |
| Australian borrowing of foreign funds ($billions) | 600 |
| Foreign borrowing of Australian funds ($billions) | 150 |
| Australian assets owned by foreigners ($billions) | 100 |
| Foreign assets owned by Australians ($billions) | 250 |

What is the value of Australia’s Net Foreign Liabilities?

1. $300 billion.
2. $400 billion.
3. $600 billion.
4. $1100 billion.
5. Capital inflows are
6. purchases of domestic goods or services by foreigners
7. purchases of domestic assets by foreigners
8. purchases of foreign goods or services by domestic households or firms
9. purchases of foreign assets by domestic households or firms
10. An increase in Australia’s net foreign liabilities will necessarily result in an increase in
11. Australia’s foreign debt.
12. income debits in the current account.
13. the trade deficit.
14. Australia’s terms of trade.

***End of Section One***

**Section Two: Data interpretation/Short response (36 Marks)**

This section contains **three (3)** questions. Answer **all** questions. Write your answers in the spaces provided.

Supplementary pages for the use of planning/continuing your answer to a question have been provided at the end of this Question/Answer booklet. If you use these pages to continue an answer, indicate at the original answer where the answer is continued, i.e. give the page number.

Suggested working time: **70** minutes.

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**Question 25 (12 marks)**

|  |  |
| --- | --- |
| 1. The purpose of a tariff is to restrict imports by increasing their price and increase domestic output & employment in the import competing industry. | 1-2 marks |
| 1. The national defence argument suggests that it is necessary to protect certain industries, such as steel, to ensure continued domestic production in the event of a war. Steel & aluminium would be considered essential inputs in the production of defence equipment. | 1- 2 marks |
| 1. *2 marks* for correctly labelled model of US steel market – showing world price, tariff, domestic production & consumption, imports.   *1 .mark for model, 1 mark for explaining model*  *2 marks for explanation* – the tariff increases domestic production & employment in the steel industry, decreases domestic consumption & reduces imports. | 1- 2 marks  1- 2 marks |
| d)  The tariff harms US consumers of steel/aluminium products by increasing prices and reducing the quantity of imports – consumer surplus decreases.  The tariff harms other US industries that use steel & aluminium as inputs in production – their costs increase, reducing employment, output & competitiveness.  Other countries are likely to retaliate & impose tariffs on US exports, harming US export industries.  *Any other reasonable argument* | 1-2 marks  1-2 marks  1-2 marks  1 – 2 marks |

**Question 26 (12 marks)**

|  |  |
| --- | --- |
| 1. 2016-17 2. 2016-17 | 1 mark  1 mark |
| 1. Services exports have risen   Depreciation in $AUD caused increase in tourism and education services | 1 mark  1 mark |
| 1. There is a direct/positive relationship between terms of trade and trade balance ie as tot decreases, trade balance decrease.   Discussion of table including figures to explain relationship  Reasoning – A rise in the XPI automatically increases the value of a given quantity of exports – e.g. if price of iron ore increases from $50/tonne to $70/tonne then 1 million tonnes of iron ore will now be worth $70 mill instead of $50 mill.  Could discuss underlying cause of tot and elasticity of goods/services in trade balance  Reward economic reasoning and use of data to support reasoning. | 1 mark  1 mark  1 - 2 mark |
| 1. This would decrease the trade balance – an increase in investment would increase capital goods imports (e.g. machinery, computers) . Could discuss long term vs short term effects ie mining boom.   Do not award for discussion on foreign investment.   1. This would increase the trade balance – a depreciation in the TWI would increase the competitiveness of Australia’s exports by lowering the price to overseas buyers, increasing export sales. | 1-2 marks  1-2 marks |

**Question 27 (12 marks)**

|  |  |
| --- | --- |
| 1. Approx. $104,000mill or $104bill – must be between $100bill - $108bill for the mark 2. No years – the stock of FDI would have increased each year 3. Mining (Resources or Commodities) | 1 mark  1 mark  1 mark |
| 1. **Foreign** **Direct Investment** (FDI) is when a foreign firm establishes a new business or acquires 10 per cent or more of an Australian enterprise.   **Foreign** **Portfolio Investment** (FPI) refers 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%). | 1 mark  1 mark |
| 1. *For both Direct & Portfolio: 1 mark for the change; 1 mark for a reason*   Between 2014-15 and 2016-17, portfolio investment more than halved from around $95bill to around $35bill. This was caused by fall in market performance – lower company profits, lower relative interest rates.  Direct investment fell from $60bill in 2014-15 to around $45bill in 2015-16, but then increased to $70bill in 2016-17 – these changes were due to the changes in commodity prices (most FDI is in the mining sector)  Any other reasonable justification | 1-2 marks  1-2 marks |
| 1. *Any 2 Benefits – 2 marks; One Cost – 1 mark*   **Benefits:** FDI helped develop Australia’s mining sector; FDI adds to real investment spending which increases output & employment; FDI can bring new technology & managerial expertise; FDI can increase labour productivity through capital deepening & thereby increasing wages.  **Costs:** FDI will lead to increased income payments to o/s investors (profits & dividends) which increases the income deficit in the current account; OR FDI can lead to increased o/s ownership of Australian businesses | 1-2 marks  1 mark |

**Section Three: Extended response (40 Marks)**

This section contains **four (4)** questions. Answer **two (2)** question. Write your answers in the lined pages provided and number your answers clearly.

Supplementary pages for the use of planning/continuing your answer to a question have been provided at the end of this Question/Answer booklet. If you use these pages to continue an answer, indicate at the original answer where the answer is continued, i.e. give the page number.

Suggested working time: 80 minutes.

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

(a) Discuss the main determinants of international competitiveness. ( 8 marks )

|  |  |
| --- | --- |
| **Description** | **Marks** |
| * Definition of International competitiveness – degree to which a country can produce goods and services which meet the test of international markets while simultaneously maintaining and expanding the real incomes of its people over the long term. * Explanation of the concept | 1  1 |
| *Determinants – At least a discussion of 3 of the following*   * Changes in labour productivity * Changes in inflation relative to trading partners * Changes in country’s wages relative to trading partners * Changes in the exchange rate | 2x3 = 6m |
| **Total** | **8** |

(b) Outline the different ways in which economies are linked and explain the economic benefits of globalisation. ( 12 marks )

|  |  |
| --- | --- |
| **Description** | **Marks** |
| * Definition of globalization * Different links – Trade, Investment, Tourism and Immigration | 1  3 |
| * *Answers need to have examples and at least 2 benefits* * **Trade benefits** * Increase in exports and imports. Exports lead to higher production, jobs, income levels and efficiency in resource use * **Investment Benefits** * Finances I-S gap, increases production, jobs, technical and managerial expertise, increased tax revenue * **Tourism** * Injection of tourism money, development of domestic infrastructure, jobs * **Immigration** * Increase in labour force, increases skills base, eases wage pressures, increases production | 1 -2 marks for each example, need 4 examples |
| **Total** | **12** |

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

1. Explain the effects of an exchange rate appreciation on consumers, businesses and foreign investment into Australia. ( 8 marks )
2. Using the demand and supply model, demonstrate the impact of the following factors on Australia’s exchange rate:
3. An increase in Australia’s interest rate differential
4. A decrease in commodity prices
5. An improvement in Australia’s economic performance ( 12 marks )

|  |  |
| --- | --- |
| 1. **Effect of ER appreciation on consumers, businesses and FI**   ER definition and causes (demand for $ increases or supply falls) of an appreciation  Consumers will benefit since imports prices will fall  Businesses that export will lose since export prices will increase for overseas buyers  Businesses that import intermediate & capital goods will benefit since import prices will fall  FI - Australian assets will now be more expensive for overseas buyers so an appreciation is likely to decrease capital inflow  Or FI could increase for the reasons seen during the mining boom | 2 marks  1 marks  3 marks  2 marks |
| 1. *4 marks for each factor – 1 mark for the model, 3 marks for the explanation. Each should have a separate D/S model.* 2. An increase in Australia’s i/r differential means that i/r’s in Australia have increased relative to o/s – this will increase foreign investment (capital inflow) into Australia, increasing the D($A) and appreciating the exchange rate. 3. A decrease in commodity prices will decrease the value of Australia’s commodity exports (iron ore, coal etc) which will decrease the D($A) and depreciate the exchange rate 4. An improvement in Australia’s economic performance will lead to an inflow of capital (esp portfolio investment) chasing higher returns from the sharemarket which will increase D($A) but at the same time higher national income will lead to increased spending on imports which will increase the S($A) so effect on the exchange rate is ambiguous. | 1-4 marks  1-4 marks  1-4 marks  Need both effects for 4 marks |

**Question 30 (20 marks)**

1. Explain what the terms of trade index measures and explain the factors that may have caused Australia’s terms of trade index to increase in 2016. ( 8 marks )

|  |  |
| --- | --- |
| **Description** | **Marks** |
| Definition of Terms of Trade and explanation: measures the relative changes in export prices and import prices. Measures the amount of exports that are needed for a given amount of imports. | 2 |
| Favourable or increase in ToT – refers to an increase in export prices relative to import prices. This implies that for a given amount of exports, more imports can be procured or for a given amount of imports less exports are needed. | 2 |
| Contemporary trends:  Late 2016 – 2017 rebound in iron ore prices due increased demand as the world economy recovers.  CHAFTA, KAFTA trade agreements led to lower import prices  Decreasing import prices. | 2  2 |
| **Total** | **8** |

1. Discuss the likely impact of a rising terms of trade on Australia’s exchange rate, trade balance and the macro-economy. ( 12 marks )

|  |  |
| --- | --- |
| **Description** | **Marks** |
| Impact on exchange rate: appreciation. Direct impact. As ToT increases demand for iron remains inelastic, this will increase in export earnings which in turn will cause demand fro $A to rise causing appreciation.  May use model.  Impact on trade balance: An increases in TOT, ceteris paribus is likely to increase export earnings – leading to an increase in BOGS. Direct relationship. However, a rise in TOT can have the opposite effect. A rise in TOT will raise national income and which will increase consumption and increase investment. This stimulates import spending decreasing BOGS.  \*Impact on Macroeconomy: expansion – positive shock to the economy. Increased investment in the resources sector will cause expansion of that sector and other related sectors. This in turn increases demand for reosurces – e.g. labour; causing unemployment to fall and income levels to rise. This also creates inflationary tendencies in the economy and inflation rises depending upon the existence of spare capacity in the economy.  *\*As as there are more impacts on the macroeconomy, so there are more available marks (up to 6). So a student could get 6 for impacts on the macro economy and 3 marks each for the ER and TB.* | 1-4  1-4  1-6 |
| **Total** | **12** |

**Question 31 (20 marks)**

1. Explain the concept of net foreign liabilities and distinguish between Australia’s two main foreign liabilities. ( 8 marks )
2. Explain the relationship between foreign liabilities and the Balance of Payments

( 12 marks )

|  |  |
| --- | --- |
| **Discussion of foreign liabilities & foreign assets** – *4 marks*  Net foreign liabilities is the difference between total foreign liabilities and total foreign assets. (1 mark)  Foreign liabilities is the stock of foreign investment into Australia, while foreign assets is the stock of Australia’s investment abroad. (1 mark)  So net foreign liabilities = foreign investment into Australia – Australian investment abroad. FI and FIA have both been increasing but FI > AIA. Therefore, Net foreign liabilities increase each year because each year there is a net inflow of capital – which is the financial account surplus (or the CAD). (1 – 2 marks)  **Discussion of foreign debt & foreign equity**  Foreign debt is the amount borrowed from non-residents by residents of Australia – both private (business) sector (75%) and the government sector (25%). Australia’s net foreign debt is approx. $1,000bn.  Foreign equity is the extent to which foreign residents own Australian assets. Australia's net foreign equity is -$25bn – which means that Australian has a positive net equity asset position (we own more overseas assets than the world owns of our assets!). | 1-4 marks    1-2 marks  1-2 marks |
| **Definition**: Balance of Payments is a record of all economic transactions between Australia and the rest of the world.  **Structure of BoP**: It has two accounts: current account and the capital and financial account. The current account records goods, services and income flows. The capital and financial account records capital transfers, foreign investment and non-produced, non-financial goods flows.  The BoP and foreign liabilities have a **direct relationship**.  **Discussion of relationship b/w FL and Financial account**  Foreign Liabilities are recorded in the financial account under either direct investment or portfolio investment. The transaction is recorded as a credit (investment) and a debit (currency) having no net effect on the balance of the capital and financial account. For example, a Chinese company opening a subsidy in Australia would record a credit on the direct investment account of the financial account and a debit for the currency flow.  **Discussion of Relationship b/w servicing of FL and current account**  The servicing of Foreign liabilities is recorded in the primary income account of the current account as a debit. This can be in the form of interest payments, dividends on shares or share of profits. For example, if an American bank has loaned an Australian company $1million dollars, the interest payments paid from Australia to America would be recorded as a debit in the primary income account (interest payments) and a credit in the financial account (currency). This creates a current account deficit and a capital and financial account surplus.  I/S gap, net foreign liabilities position, leads to deficit on the income account and persistant current account deficit (capital/financial account surplus)  **Any other reasonable suggestion**: could discuss Australia’s reliance on foreign investment means we have increased economic growth which affects trade balance.  Note: Many students not understanding the point of the balanced transactions – marks were not taken away for this but if it meant their conclusions were incorrect then marks could not be awarded for the above. | 1 mark  1-2 marks  1 mark  1 – 3 marks  1 – 3 marks  1 – 2 marks  1 mark |

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***End of Questions***