

**Year 12 Economics Exam Semester 2 2019**

**Marking Guide**

**Section 1 (24 marks)**

1 C

2 C

3 B

4 A

5 B

6 D

7 C

8 A

9 A

10 D

11 C

12 B

13 B

14 D

15 C

16 B

17 D

18 A

19 D

20 C

21 A

22 D

23 A

24 B

**Section 2 (36 marks)**

**Question 25 (12 marks)**

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| a. i. 2012  Reason: Mining boom  a. ii. Annual: 1.8% (+/- 0.1)  Quarterly: 0.4 (accept 0.3 but not 0.5) | 1 mark  1 mark  1 mark  1 mark |
| b. The decline was due to  1. Reduced growth of consumption (C) – due to fall in house prices reducing household wealth & subdued growth in wages  2. Decline in investment (I) – due to fall in mining investment; fall in business confidence (uncertain global outlook)  Note **not** due to falls in NXs or G | 1-2 marks  1-2 marks |
| c. 2 marks for explanation referring to 2-3 current indicators  The economy is growing below trend, real GDP growth is well below the target of around 3%. This means that the unemployment rate (above 5%) will be above the natural rate, while the inflation rate (<2%) will be below the target range.  2 marks for AD/AS model showing the economy in equilibrium below potential GDP – to the left of the LRAS curve (caused by relative fall in AD curve | 1-2 marks  1-2 marks |

**Question 26 (12 marks)**

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| a. i. 2-3%  ii. 4.5% | 1 mark  1 mark |
| b. Spare capacity in the economy means that real GDP is below potential GDP – there is scope for the economy to expand production without causing the price level (or inflation) to rise. Spare capacity in the labour market means that the unemployment rate is above the full employment rate. Unemployment can fall without causing an increase in wages. | 1-2 marks |
| c. Discuss two reasons for depreciation – 2 marks  Reduced demand for $A due to weaker world trade growth  Aust’s interest rate differential had fallen reducing D($A)  The RBA would prefer a lower $A to help stimulate net exports & increase AD. | 1-2 marks  1 mark |
| d. The Reserve Bank would hope that by lowering the cash rate, both consumption & investment would increase due to increased cash flow & lower borrowing costs which would increase aggregate demand, causing the price level (inflation) to rise.  Effect of monetary policy is limited when the economy is ‘weak’ – when outlook is negative (business & household confidence are low), cutting i/rs may have little impact on spending.  Cuts in i/rs may not be passed on by banks | 1-3 marks  1-2 marks |

**Question 27 (12 marks)**

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| a. i. Measures changes in the prices of Australia’s commodity (resource) exports, weighted to reflect its importance in total exports – e.g. iron ore, coal, natural gas, gold, wheat  iii. Approx. $7bn ($8bn - $1bn) | 1 mark  1 mark |
| b. There is a positive relationship  A rise in the commodity price index causes an increase in the trade balance (& vice versa) because most of Aust’s exports are commodities – a rise in price increases their value | 1 mark  1-2 marks |
| c. Depreciation of the $A – this would increase the trade balance by reducing the price of Aust’s exports thereby increasing qty sold, & increase price of imports to Aust buyers reducing qty purchased.  Increased demand for exports due to Aust’s many recent free trade agreements (FTAs); higher demand for Aust’s resource exports from China &/or India | 1-2 marks  1 mark |
| d. 2 marks explanation  Increased trade balance would (ceteris paribus) have a **multiplier** effect on the economy, increasing production, income and employment.  2 marks for model  Could use either an AE model showing a shift of the AE line upwards, increasing the equilibrium level of income  OR  An AD/AS model showing a shift of the AD curve to the right, increasing real GDP & the price level | 1-2 marks  1-2 marks  1-2 marks |

**Section 3 (40 marks)**

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

(a) Discuss the significance of trade for the Australian economy, including a description of the composition and direction of Australia’s trade. (10 marks)

(b) Explain the reasons why the Australian government is committed to promoting free trade rather than a more protectionist stance. Use a model to help support your answer. (10 marks)

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| (a) Significance of trade – 5 marks  Discuss importance of trade – both exports & imports – to the Australian economy   * Trade (exports & imports) accounts for over 40% of GDP * More than 1 in 5 jobs is related to trade * Exports increase Australia’s production & GDP while imports increase Australia’s consumption possibilities * Increases in net exports increase aggregate demand which boosts Australia’s GDP growth   Composition & direction of Aust’s trade – 5 marks   * The mining industry accounts for most of Australia’s exports but education & tourism are also important service exports * Aust tourists travelling overseas are Aust’s largest import, while motor vehicles & petroleum are other significant imports * China, Japan & US are Austs major trading partner | 1-5 marks  1-5 marks |
| (b) Free trade policy vs protectionist stance – 10 marks  Should discuss the benefits of free trade (1-5 marks) over the costs of protectionism (1-3 marks) & 1-2 marks for use of a model. The model must relate to the discussion – either free trade model showing world price or tariff model showing costs (don’t need both)  The benefits for free trade (trade liberalisation): 1-5 marks   * Specialisation based on comparative advantage achieves greater efficiency, better resource allocation & higher living standards * Higher levels of real income & consumption * Countries can consumer above their PPF * Higher world price for exporters; Lower world price for importers * Greater variety of goods & services * Lower cost for imported inputs * Greater access to technology * Promotes higher productivity & therefore higher economic growth   The costs of protectionist policies: 1-3 marks   * Higher costs/higher prices * Lower living stds * Reduced economic growth * Resources attracted to inefficient industries | Perhaps 1-5 for benefits  1-3 for costs  1-2 for use of model |

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

(a) Discuss the concept of foreign investment in terms of foreign assets and foreign liabilities and explain why Australia has a relatively high level of net foreign liabilities. (10 marks)

(b) What is foreign direct investment? Evaluate the benefits and costs of foreign direct investment to the Australian economy. (10 marks)

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| a. Foreign assets – Australian investment abroad – when Aust residents purchase overseas assets – business, property, shares. It equals what Australia ‘owns’ to the rest of the world. Aust’s total foreign assets = $2600bn approx.  Foreign liabilities – foreign investment into Australia – when foreign residents purchase Australian assets – business, property, shares. It equals what Australia ‘owes’. Aust’s total foreign liabilities = $3600bn approx.  Aust’s foreign liabilities are much greater than our foreign assets:  Net foreign liabilities = Foreign liabilities – foreign assets (approx. $1000bn)  Aust’s net foreign liabilities have increased over time because Australia has an investment-savings gap. Each year Aust records a current account deficit (net capital inflow) which increases the stock of net foreign liabilities. Most of this comprises foreign debt rather than foreign equity. As long as Australia has a shortfall of savings to fund its investment, then it relies on foreign investment to supplement domestic savings. | 1-2 marks  1-2 marks  1-6 marks |
| b. **Foreign** **Direct Investment** (FDI) is when a foreign firm establishes a new business or acquires 10 per cent or more of an Australian business, and so has some control over its operations. Provide an example such as the establishment of Australian branches of multinational companies or joint ventures between Australian and foreign companies.  Benefits: Australia has relied on FDI over the past century to develop its resources & industries; FDI has helped to fill the I – S gap; 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; FDI can lead to increased o/s ownership of Australian businesses  Evaluate – concluding statement that the benefits from FDI far exceed the costs | 1-3 marks  1-4 marks  1-2 marks  1 mark |

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

(a) *In May 2018, the Government planned for a budget deficit of $14.5bn. The actual budget outcome was a deficit of just $4bn.* Explain the reasons for this difference and discuss whether this would have an expansionary or contractionary effect on the economy. (10 marks)

(b) Discuss three strengths and two weaknesses of fiscal policy. (10 marks)

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| a. Reasons for difference between planned & actual – 5 marks  Planned revenue & govt spending is based on many assumptions such as GDP growth, employment growth, unemployment rate, inflation rate, price of iron ore, exchange rate etc. If any of these assumptions are incorrect, then estimates will not be accurate.  Automatic stabilisers – which relate to above but should be mentioned & explained. Reward specific examples – e.g. during 2018-19 unemployment was lower than predicted which caused welfare spending to be lower & tax revenue to be higher, reducing the deficit. The iron ore price was much higher than predicted resulting in higher royalties from iron ore exports  Expansionary/contractionary effect  Simple answer is that a fall in the budget deficit will have a contractionary effect on the economy because less money is being injected into the economy  Better answer is that the stance is determined by the structural budget outcome – related to the discretionary part of fiscal policy. Aust’s structural budget is in deficit, which means that it is expansionary even though the deficit is falling e.g. the govt has lowered tax rates on small business & increased spending on infrastructure. The reason why the budget deficit has fallen is because automatic stabilisers have reduced the cyclical component – this does not affect the stance. | 1-2 marks  1-3 marks  (1-2 marks)  1-5 marks |
| b. Discuss (not list) any 3 **strengths** – 6 marks (3 x 2 marks)  FP has a very short effect lag – once implemented it is very quick to affect aggregate demand – e.g. an increase in G or a cut in T will have multiplier effects to increase real GDP  FP is very effective when economy is in contraction  FP can be used to target specific sectors of the economy – specific income groups, industries, age groups  FP can affect the AS curve as well as the AD curve – through investment in infrastructure, spending on training & education  Discuss (not list) any 2 **weaknesses** – 4 marks (2 x 2 marks)  FP suffers from long decision (implementation) lag – it takes time for decisions to be made through the parliamentary process  FP may be politically biased to suit the govt rather than the economy  FP is relatively inflexible – Budget is planned 12 months in advance | 1-6 marks  1-4 marks |

**Question 31 (20 marks)**

(a) Distinguish between the factors that affect the aggregate demand (AD) curve and factors that affect the aggregate supply (AS) curve. (10 marks)

(b) Discuss the meaning and importance of the concept of productivity. Use the AD/AS model to explain the effects of an increase in productivity on the economy. (10 marks)

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| a. The AD curve shows how total spending in the economy is affected by a change in the price level – as the price level falls, total spending rises (the AD curve has a negative slope).  The AD curve consists of C, I G plus NXs. Any changes in these four components of spending will shift the AD curve. e.g. an increase in G will shift the AD curve to the right. An increase in income tax will decrease C and shift the AD curve to the left.  The AS curve shows how a change in real GDP causes the price level to change – as real GDP increases, production costs rise which increases the price level. (the AS curve has a positive slope).  The AS curve reflects the stock of labour, capital & natural resources as well as the state of technology. An increase in the labour force or capital stock will shift the curve to the AS curve right. It is also affected by changes in production costs – an increase in wage costs will shift the AS curve to the left. | 1-2 marks    1-3 marks  1-2 marks  1-3 marks |
| b. Discuss meaning & importance of productivity – 4 marks  Meaning – output per unit of input e.g. GDP per hour worked, on average how much does each worker produce. Should mention difference between labour productivity & multifactor productivity  Importance – growth in productivity is the key to rising living stds & rising real incomes  Effects using AD/AS model – 6 marks  An increase in productivity will increase aggregate supply – shift both the SR & LR AS curves to the right. Explain why – increase in productivity reduces unit costs.  (Note it will also increase AD due to higher real incomes, higher C & I – many students will leave this out)  Effect will be to increase employment & real GDP & lower the price level (inflation)  Correct AD/AS model | 1-2 marks  1-2 marks  1-2 marks  1-2 marks  1-2 marks |