Economics Teachers' Association of Western Australia

Year 12 Semester 2 Exam 2022 – Marking Guide

SECTION 1: Multiple choice **(24 marks)**

Question	Answer
1	D
2	C
3	C
4	A
5	B
6	C
7	B
8	A
9	D
10	B
11	C
12	D
13	A
14	C
15	B
16	A
17	D
18	A
19	D
20	B
21	D
22	C
23	A
24	B

SECTION 2: Data interpretation/ Short answer (36 marks)

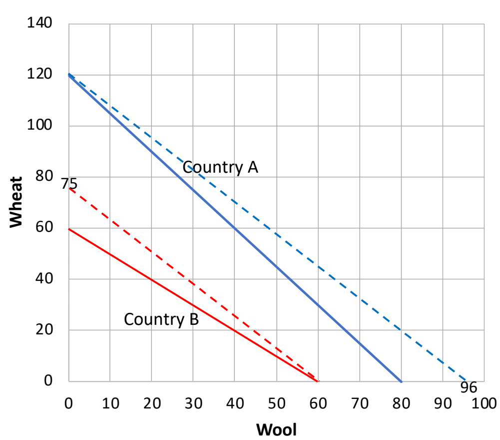
Question 25 (12 marks)

(a) i Determine which country has the comparative advantage in each good.

Description	Mark
Wheat – Country A	1
Wool – Country B	1
Total	**2**

(a) ii If after specialisation, 1 wheat trades for 0.8 wool, draw and label each countries consumption possibilities frontier on the diagram.

Description	Mark
Country A's CPF: 120 wheat & 96 wool	1
Country B's CPF: 60 wool & 75 wheat	1
Total	**2**



The dotted lines represent the consumption lines for each country after trade given the terms of trade:

1 wheat trades for 0.8 wool

1 wool trades for 1.25 wheat

(b) Demonstrate and explain how imports can result in an increase in economic welfare.

Description	Mark
World price line drawn below the equilibrium price	1
Imports correctly labelled on the model	1
Imports result in a decrease in producer surplus & an increase in consumer surplus	1
There is a net increase in total surplus	1
Total	**4**

(c) Explain how a subsidy paid to an import competing industry would affect consumer surplus, producer surplus and overall market efficiency.

Description	Mark
Marks awarded for the following points in explanation:	
A subsidy would increase domestic production resulting in an increase in producer surplus.	1
A subsidy does not affect consumers – price & qty demanded do not change so there is no change to consumer surplus.	1

There is a decrease in total surplus because the cost of the subsidy is greater than the gain in producer surplus.	1-2
Total	**4**

Question 26 (12 marks)

(a) i State the meaning of the dotted line in the business cycle diagram.

Description	**Mark**
The dotted line represents the trend level of real GDP or potential (full employment) real GDP.	1
Total	**1**

(a) ii Show the position of the economy for the **two** time periods.

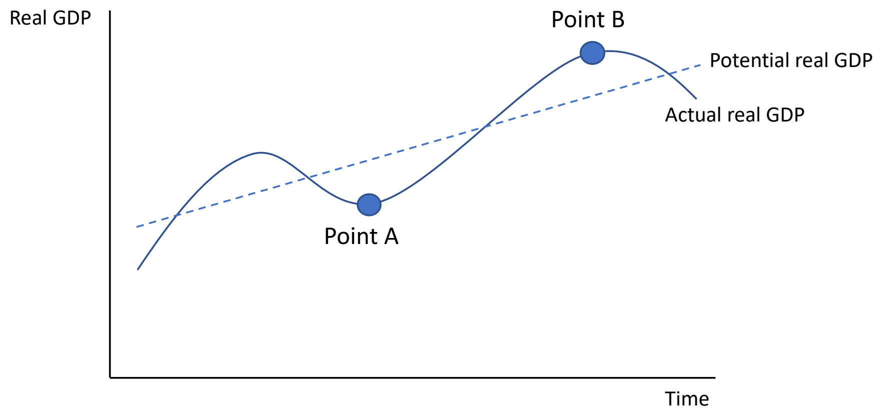
Description	**Mark**
Refer to the diagram below:	
Point A would be located at the trough of the cycle (recession)	1
Point B would be at the peak of the cycle	1
Total	**2**

(b) Refer to **two** economic indicators to explain your choice for point B.

Description	**Mark**
Justify point B – the economy is in a boom	
Explains a correct indicator	2
Identifies a correct indicator	1
Total (x2)	**4**
Answers should include: 1) The low unemployment rate of 3.9% is below the natural rate of unemployment estimated to be between 4-4.5%. 2) The high inflation rate of 5.1% is well above the target range of 2-3% indicating the presence of strong demand inflation. Note: GDP & employment indicators are not high enough for a boom.	

(c) Use the aggregate expenditure (AE) model to explain the effect of the change in house prices.

Description	**Mark**
Marks awarded for the following points in explanation:	
The median house price increased by 30% during the period which would have increased household wealth.	1
An increase in wealth would increase household consumption.	1
An increase in C would shift the AE line up resulting in a multiplier effect on real GDP.	1
AE model	
Correctly labelled AE Model showing AE line shift up & the increase in equilibrium GDP.	1-2
Total	**5**



Question 27 **(12 marks)**

(a) To what extent has the Reserve Bank achieved its economic objectives?

Description	Mark
States that price stability has not been achieved because the inflation rate is above the target range of 2-3%.	1
States that full employment has been achieved given that the unemployment rate is at a record low.	1
Comments on the achievement of the economic prosperity & welfare objective – can argue either way on this (high prosperity but high inflation is a negative)	1
Total	**3**

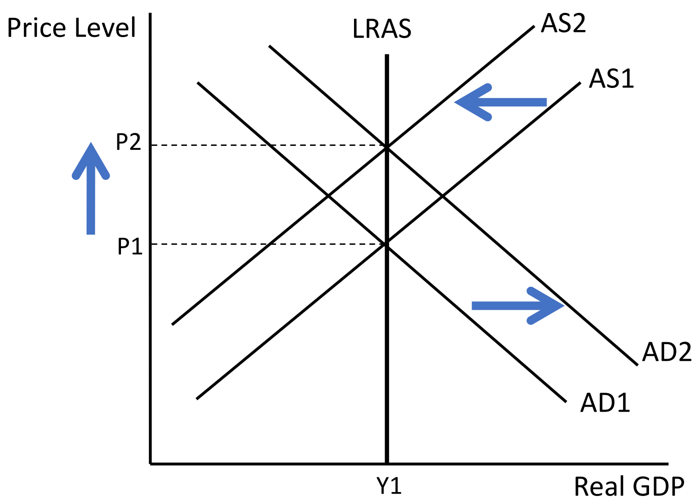
(b) Use the AD/AS model to illustrate and explain the effect of **one** demand and **one** supply factor on Australia's inflation rate.

Description	Mark
Explanation of factors	
Correctly identifies one demand factor shifting the AD curve to the right – e.g. very low unemployment rate increasing C; high commodity prices increasing net exports	1
Correctly identifies one supply factor shifting the AS curve to the left – e.g. high global oil prices; floods in eastern Australia; supply bottlenecks	1
The AD/AS model	
Correctly labelled AD/AS model showing the shift of each curve resulting in a large rise in the price level. (see diagram below)	1-2
Total	**4**

(c) Explain how **two** channels of the monetary policy transmission mechanism could return inflation to its target range.

Description	Mark
States that The Reserve Bank will increase the cash rate to increase interest rates in the economy to reduce aggregate demand and reduce inflation.	1
Explanation of two channels	
An increase in interest rates will increase the **cost of borrowing** which will help to reduce both consumption and investment and decrease aggregate demand.	1-2

An increase in interest rates will reduce the **cash flow** of both households and firms that have existing debt which will reduce spending and decrease aggregate demand.	1-2
(An increase in interest rates will reduce asset prices which will decrease wealth and reduce consumption spending).	(1-2)
Total	**5**



SECTION 3 (40 marks)

Question 28 (20 marks)

(a) Use a demand/supply model to explain how an increase in Australia's terms of trade will affect Australia's trade weighted index. (8 marks)

Description	**Mark**
Definitions	
Define the terms of trade	1
Define the trade weighted index	1
Sub-total	**2**
Explanation	
Detailed explanation of how an increase in the terms of trade will affect the TWI	3
Part explanation of how an increase in the terms of trade will affect the TWI	2
States that an increase in the terms of trade will increase the TWI	1
Sub-total	**3**
Model	
Fully labelled model of the TWI exchange rate showing an increase in D(AUD) resulting in an appreciation.	3
Partly labelled model of the TWI exchange rate showing an increase in D(AUD) resulting in an appreciation.	2
An attempt at drawing the model	1
Sub-total	**3**
Total	**8**
Answers may include: An increase in the terms of trade means that export prices have risen relative to import prices. This will increase the value of Australia's exports and result in an increase in demand for AUD in the foreign exchange market. This will cause the AUD, measured by the TWI, to appreciate.	

(b) Explain **three** effects of a rise in both the trade weighted index and the terms of trade index on the Australian economy. (12 marks)

Description	**Mark**
Effects of a rise in the TWI (x 3 effects)	
Correctly explains an effect	2
Describes an effect	1
Subtotal (x 3)	**6**
Effects of a rise in the terms of trade (x 3 effects)	
Correctly explains an effect	2
Describes an effect	1
Subtotal (x 3)	**6**
Total	**12**

Answers should include:

Effects of a rise in the Trade weighted index (TWI)

- A rise in the TWI will increase the price of Australian exports to overseas buyers & decrease the price of imports to Australian buyers.
- A rise in the TWI will reduce the trade balance & the current account balance.
- A rise in the TWI will have a contractionary effect on the economy – net exports will fall.
- A rise in the TWI will reduce imported inflation reducing costs for Australian firms using imported goods.

Effects of a rise in the terms of trade

- A rise in the terms of trade will increase export receipts which will increase the trade balance and the current account balance.
- A rise in the terms of trade will have an expansionary effect on the economy, increasing aggregate demand.
- A rise in the terms of trade will increase national income and raise average living standards.

Question 29 **(20 marks)**

(a) Outline the trend in Australia's current account balance since 2019 and explain **four** reasons for this trend. (10 marks)

Description	**Mark**
Outline the trend in the current account balance	
Correctly outlines the trend	2
An attempt at describing the trend	1
Subtotal	**2**
Reasons for this trend	
Explains a reason for this trend	2
Outlines a reason for this trend	1
Subtotal (x 4)	**8**
Total	**10**

Answers should include: Since 2019, Australia's current account balance has increased since 2019 and has recorded has been in surplus and increasing until 2022. Reasons for this trend: • Reason 1: Strong commodity prices (iron ore, coal, natural gas) have increased Australia's export receipts increasing the trade balance. • Reason 2: The income balance (deficit) has been increasing (decreasing) due to very low global interest rates and falling foreign investment into Australia. • Reason 3: The Covid pandemic caused a recession in Australia which decreased spending on imports, esp. outbound tourism, which increased the trade balance. • Reason 4: Since 2019, Australia's saving has increased to be greater than Australia's investment. When S > I, a country will record a current account surplus. • Reason 5: A low AUD during this period increased the competitiveness on Australia's exports increasing the trade balance.

(b) Explain the concept of foreign direct investment and describe **two** benefits and **two** costs of an increase in foreign direct investment into the Australian economy. (10 marks)

Description	**Mark**
Explanation of FDI	
Explains foreign direct investment (correct definition)	2
Describes foreign direct investment (partly correct definition)	1
Subtotal	**2**
Benefits of an increase in FDI	
Describes a benefit	2
Identifies a benefit	1
Subtotal (x2)	**4**
Costs of an increase in FDI	
Describes a benefit	2
Identifies a benefit	1
Subtotal (x2)	**4**
Total	**10**

Answers should include:

Foreign direct investment (FDI) is when an overseas investor establishes a new business in Australia or acquires 10 per cent or more of an Australian enterprise, and so has some control over its operations.

Benefits include: expands Australia's industrial and manufacturing base; increases Australia's production and employment; boosts productivity by injecting new capital into domestic firms; transfer of new technology and managerial expertise; increases tax revenue to the Australian government.

Costs include: loss of ownership and/or control of domestic enterprises; company profits may be remitted overseas; increased FDI maybe associated with increased foreign debt resulting in interest payments to overseas residents; increased FDI is likely to appreciate the exchanger rate reducing the competitiveness of exports.

Question 30 **(20 marks)**

Between 2019-20 and 2021-22, the government recorded budget deficits of $85 billion, $134 billion and $80 billion.

(a) Explain three reasons for these record budget deficits and describe why the Government's budget deficit is expected to fall significantly by 2025-26. (8 marks)

Description	**Mark**
Reasons for the large budget deficits (x3)	
Explains a reason for the budget deficits	2
Outlines a reason for the budget deficits	1
Subtotal (x3)	**6**
Why the budget deficit will fall	
Describes why the budget deficit will fall	2
Identifies why the budget deficit will fall	1
Subtotal	**2**
Total	**8**

Answers should include:

States the meaning of a budget deficit: when G > T.

Reasons for large budget deficits (three)

- The large budget deficits were a direct result of the impact of the Covid 19 pandemic. The economy was plunged into recession as economic activity, production and employment all fell.
- Need to discuss factors that increase government spending and decrease government revenue.
- The government introduced a range of stimulus measures to help save jobs and lessen the impact of the pandemic, including special payments to both households and firms, including the jobkeeper payment. Government spending on healthcare dramatically increased, including the purchase of vaccines.
- At the same time, govt spending on welfare automatically increased due to the significant rise in unemployment, while tax receipts from income tax, company tax and the GST all fell due to the shutdown of the economy.
- There were a series of natural disasters that increased government spending, increasing the size of the deficits – drought in 2019, bushfires of 2019-20 and floods in 2021-22

Why the budget deficit will fall

- Stimulus spending is no longer required
- Economy has recovered with strong growth and record low unemployment – automatic stabilisers will result in significant falls in the budget deficit as welfare spending falls and tax receipts increase.

(b) Discuss **three** strengths and **three** weaknesses of using fiscal policy to stabilise the business cycle. (12 marks)

Description	Mark
Strengths of fiscal policy (x3)	
Discusses a strength of using fiscal policy to stabilise the business cycle	2
Describes a strength of using fiscal policy to stabilise the business cycle	1
Sub-total (x3)	**6**
Weaknesses of fiscal policy (x3)	
Discusses a weakness of using fiscal policy to stabilise the business cycle	2
Describes a weakness of using fiscal policy to stabilise the business cycle	1
Sub-total (x3)	**6**
Total	**12**

Answers may include:
Strengths
- Fiscal policy is very powerful when responding to a recession in the business cycle – government spending makes up around 25% of GDP and can be used as a 'spending tap' to increase aggregate demand.
- Changes in taxes (income and company) can be used to directly affect both consumption and investment in order to either increase or decrease aggregate demand.
- The effect lag of fiscal policy is very short – changes in G &/or T can have immediate effects on the level of aggregate demand.
- Both G and T have multiplier effects which can help to either increase or decrease economic activity to counter swings in the business cycle.
- The operation of automatic stabilisers is an advantage to help offset swings in the business cycle – e.g. when the economy contracts, welfare spending automatically increases which helps to boost aggregate demand.

Weaknesses
- Fiscal policy is less powerful when responding to a boom in the business cycle – it can be difficult to suddenly decrease government discretionary spending.
- Fiscal policy suffers from a long decision & implementation lag – decisions often have to be debated & passed in Parliament while a large bureaucracy can slow the process of implementation.
- Fiscal policy can suffer from 'crowding out' – e.g. increases in government spending may lead to offsetting decreases in private spending which reduces the effectiveness of fiscal policy.
- Fiscal policy can be swayed by politics and placating voters, which can lead to poor decisions that are not informed by data -e.g. during a boom, the government is unlikely to increases taxes to slow down economic activity.
- Expansionary fiscal policy will result in budget deficits and an increase in public debt which can increase the tax burden on future generations.

Question 31 **(20 marks)**

(a) Explain the meaning and importance of the marginal propensity to consume. Use the aggregate expenditure model to explain the effects of an increase in the marginal propensity to consume on the equilibrium level of income. (8 marks)

Description	**Mark**
Meaning of the marginal propensity to consume (MPC)	
Explains the meaning of the MPC	2
Describes the meaning of the MPC	1
Sub-total	**2**
Importance of the marginal propensity to consume	
Explains the importance of the MPC	2
Describes the importance of the MPC	1
Sub-total	**2**
Effects of an increase in the marginal propensity to consume	
Explains the effects of an increase in the MPC	2
Describes the effects of an increase in the MPC	1
Sub-total	**2**
Correct illustration of the AE model	2
Partly correct illustration of the AE model	1
Sub-total	**2**
Total	**8**

Answers may include:

The marginal propensity to consume (MPC) refers to the change in a person's consumption when their income changes: MPC = change in C/change in Y. If your income rises by $100 and you spend an extra $60, then your MPC = 0.6.

The importance of the MPC is that it determines the value of the multiplier. The multiplier concept refers to the effect of a change in autonomous spending on real GDP. For example if investment increases by $100bn and GDP increases by $400bn, the multiplier would equal 4.

The formula for the multiplier is 1 / (1-MPC). If the MPC = 0.6, the multiplier = 2.5. As the MPC increases, the multiplier increases.

An increase in the MPC will mean that consumers will want to spend a higher proportion of any increase in income – this will cause the slope of the consumption function to increase. This means that the AE line will swivel upwards. A higher MPC will increase the value of the multiplier and will cause the equilibrium level of income to increase.

(b) Use the aggregate demand/aggregate supply (AD/AS) model to illustrate and explain the impact of each of the following events on the Australian economy.

i. An increase in government investment.
ii. A decrease in the working age population.
iii. A depreciation of the AUD

(12 marks)

Description	**Mark**
An increase in government investment	
Explains the impact on the economy	2
Describes the impact on the economy	1
Sub-total	**2**
Correct illustration of the AD/AS model	2
Partly correct illustration of the AD/AS model	1
Sub-total	**2**
A decrease in the working age population	
Explains the impact on the economy	2
Describes the impact on the economy	1
Sub-total	**2**
Correct illustration of the AD/AS model	2
Partly correct illustration of the AD/AS model	1
Sub-total	**2**
A depreciation of the AUD	
Explains the impact on the economy	2
Describes the impact on the economy	1
Sub-total	**2**
Correct illustration of the AD/AS model	2
Partly correct illustration of the AD/AS model	1
Sub-total	**2**
Total	**12**

Answers may include:

Note: in each case both the AD & the AS curve will shift!

An increase in government investment will increase AD – shift the AD curve to the right, but it will also increase AS – shift the AS curve to the right because infrastructure such as roads, bridges, railways & communication networks increase the capital stock. Real GDP will increase, but the effect on the price level is uncertain.

A fall in the working age population will decrease AD – shift the AD curve to the left because C will fall, but it will also shift the AS curve to the left because the labour force will fall. Real GDP will decrease, but the effect on the price level is uncertain.

A depreciation of the AUD will increase AD – shift the AD curve to the right because net exports will increase. But it will also decrease AS – shift the AS curve to the right because higher import prices will increase costs. Real GDP will increase (AD effect is stronger) while the price level will increase.