



ECONOMICS

ATAR course examination 2017

Marking Key

Marking keys are an explicit statement about what the examining panel expect of candidates when they respond to particular examination items. They help ensure a consistent interpretation of the criteria that guide the awarding of marks.

Section One: Multiple-choice

24% (24 Marks)

| Question | Answer |
|----------|--------|
| 1 | c |
| 2 | d |
| 3 | c |
| 4 | b |
| 5 | a |
| 6 | a |
| 7 | d |
| 8 | b |
| 9 | a |
| 10 | c |
| 11 | d |
| 12 | b |
| 13 | b |
| 14 | d |
| 15 | c |
| 16 | a |
| 17 | b |
| 18 | a |
| 19 | d |
| 20 | c |
| 21 | a |
| 22 | d |
| 23 | b |
| 24 | c |

Section Two: Data interpretation/Short answer

36% (36 Marks)

Question 25

(12 marks)

- (a) (i) At what rate did global trade increase by in 2016? (1 mark)

| Description | Marks |
|----------------------|----------|
| less than 2 per cent | 1 |
| Total | 1 |

- (ii) Identify
- one**
- reason for the 'investment crash in advanced economies'. (1 mark)

| Description | Marks |
|--|----------|
| One reason from the following: | |
| <ul style="list-style-type: none"> • poor productivity • still-damaged banking systems • ongoing budget deficits that crowd out investment funding • slowdown in Chinese economic growth • global debt that has never been higher | 1 |
| Total | 1 |

- (iii) What is the role of the World Trade Organisation (WTO)? (1 mark)

| Description | Marks |
|---|----------|
| to deal with the promotion and liberalisation of world trade by helping to lower trade barriers | 1 |
| Total | 1 |

- (b) Use the aggregate expenditure (AE) model to demonstrate and explain the impact of falling investment on real gross domestic product (GDP) in an economy. (4 marks)

| Description | Marks |
|--|----------|
| Explanation | |
| Writes a clear explanation linking falling investment to the negative multiplier causing a bigger than proportional change in real GDP. Refers to the diagram in the explanation | 2 |
| Writes an explanation with a link between falling investment and change in real GDP | 1 |
| Subtotal | 2 |
| Diagram | |
| Provides a fully-labelled diagram demonstrating bigger than proportional change in real GDP as a result of falling investment | 2 |
| Provides a diagram that demonstrates declining investment and real GDP, with some attempt at labelling | 1 |
| Subtotal | 2 |
| Overall total | 4 |

Question 25 (continued)

- (c) Explain how the operation of **one** type of ‘restrictive international trade measure’ (protection) reduces market efficiency. Draw an appropriate model to support your explanation. (5 marks)

| Description | Marks |
|---|----------|
| Explanation | |
| Explains the decline of market efficiency by referring to either total surplus falling (or deadweight loss or net welfare loss) and includes clear reference to the diagram | 3 |
| Describes the effect on price and quantity | 2 |
| Identifies a type of protection (e.g. tariffs, subsidies) | 1 |
| Subtotal | 3 |
| Diagram | |
| Shows clearly the reduction in total surplus (deadweight loss) as a consequence of the protection. Labels the diagram correctly | 2 |
| Demonstrates the impact of protection on price and quantity | 1 |
| Subtotal | 2 |
| Overall total | 5 |

Question 26

(12 marks)

- (a) (i) Calculate the terms of trade for the December quarter 2016. (1 mark)

| Description | Marks |
|-----------------------|----------|
| 83.7 rounded (83.739) | 1 |
| Total | 1 |

- (ii) What does the terms of trade index measure? (1 mark)

| Description | Marks |
|--|----------|
| the relative movements in the prices of exports and imports OR measures the quantity of imports that can be purchased from a volume of exports | 1 |
| Total | 1 |

- (iii) In what quarter of 2016 did the average price of imports increase? (1 mark)

| Description | Marks |
|------------------|----------|
| December quarter | 1 |
| Total | 1 |

- (b) Describe the trend in Australia’s terms of trade evident in the table and identify **two** possible economic reasons for this trend. (3 marks)

| Description | Marks |
|---|----------|
| Trend | |
| Describes the trend as favourable/rising/improving | 1 |
| Subtotal | 1 |
| Reasons | |
| Identifies two possible economic reasons for this trend | 2 |
| Identifies one possible economic reason for this trend | 1 |
| Subtotal | 2 |
| Overall total | 3 |
| Possible reasons for the trend include: | |
| <ul style="list-style-type: none"> • higher commodity prices • lower manufactured goods prices • lower oil prices. | |

- (c) Describe the likely effect of the movement in the terms of trade, shown in the table on the previous page, on the following: Exchange rate; Trade balance; Inflation rate. (6 marks)

| Description | Marks |
|--|----------|
| Exchange rate | |
| Favourable movement in terms of trade causes higher demand for AUD to pay for the increased price of exports compared to supply of AUD. This would cause an appreciation | 2 |
| Correctly states that an appreciation is likely | 1 |
| Subtotal | 2 |
| Trade balance | |
| Favourable movement in terms of trade means more money being earned from exports compared to paid-for imports. Ceteris paribus, the trade balance should increase | 2 |
| Correctly states that trade balance should improve | 1 |
| Subtotal | 2 |
| Inflation rate | |
| Favourable terms of trade results in higher national income, investment and spending, producing an expansionary impact and, therefore, higher inflation/price pressure | 2 |
| OR | |
| States a lower inflation rate due to higher exchange rate or lower MPI | |
| Correctly states that inflationary pressure will rise | 1 |
| Subtotal | 2 |
| Overall total | 6 |

Question 27

(12 marks)

- (a) (i) What is meant by the phrase 'government budget deficit'? (1 mark)

| Description | Marks |
|---|----------|
| Government revenue is less than expenditure | 1 |
| Total | 1 |

- (ii) Identify the year with the largest budget deficit. (1 mark)

| Description | Marks |
|--------------|----------|
| 2010 | |
| Total | 1 |

- (iii) Between which **two** years was the budget most contractionary? (1 mark)

| Description | Marks |
|--------------|----------|
| 2012–2013 | 1 |
| Total | 1 |

- (b) Identify **three** methods the government could use to finance a budget deficit. (3 marks)

| Description | Marks |
|--|----------|
| Identifies three methods of financing a budget deficit | 3 |
| Identifies two methods of financing a budget deficit | 2 |
| Identifies one method of financing a budget deficit | 1 |
| Total | 3 |
| Methods include: <ul style="list-style-type: none"> • selling government bonds – financial instrument is sold by the government to investors with surplus funds • borrowing from the central bank which injects new money into the economy and therefore, has an expansionary impact • borrowing from overseas • selling of government assets. | |

- (c) Discuss the likely impact on the level of economic activity of the Australian Government's fiscal policy stance from 2014 to 2016. (6 marks)

| Description | Marks |
|---|----------|
| Identifies the fiscal policy stance | 1 |
| Identifies reason for the stance | 1 |
| Refers to the data | 1 |
| Subtotal | 3 |
| Discusses the impact with three clear points | 3 |
| Discusses the impact with two clear points | 2 |
| Discusses the impact with one clear point | 1 |
| Subtotal | 3 |
| Overall total | 6 |
| <p>Answers could include but are not limited to:</p> <ul style="list-style-type: none"> • 2014–2015 contract because budget deficit is smaller • 2015–2016 is neutral because budget deficit does not change • 2014–2016 expansionary based on budget deficit. <p>Impacts:</p> <ul style="list-style-type: none"> • GDP • price level • interest rates • automatic stabilisers • crowding out • multiplier • the goal is medium term return to surplus and a balanced budget over the course of the economic cycle. | |

Section Three: Extended answer

40% (40 Marks)

Question 28

(20 marks)

- (a) Describe the structure of Australia's balance of payments accounts. Include examples of international transactions that would occur in each category. (8 marks)

| Description | Marks |
|---|----------|
| Structure and categories | |
| Describes correctly the three categories of the Current Account. Describes correctly the two categories of the Capital and Financial Account | 4–5 |
| Describes most of the three categories of the Current Account. Describes most of the two categories of the Capital and Financial Account | 2–3 |
| Identifies some of the categories of the Current Account and Capital and Financial Account. | 1 |
| Subtotal | 5 |
| Use of examples | |
| Includes a range of appropriate examples allocating credit and debit | 2 |
| Uses limited examples | 1 |
| Subtotal | 2 |
| Australian references | |
| Makes reference to characteristics of Australia's Balance of Payments (i.e. CAD, FAS) | 1 |
| Subtotal | 1 |
| Overall total | 8 |
| <p>Answers could include but are not limited to:</p> <p>Structure and categories</p> <ul style="list-style-type: none"> • Current Account: <ul style="list-style-type: none"> • Goods – transactions involving merchandise/products • Services – transactions involving services such as tourism, education, etc. • Income – financial transactions such as interest and dividend payments, etc. <p>Current and Financial Account:</p> <ul style="list-style-type: none"> • capital transfers • financial account – transactions that change the ownership of foreign financial assets and liabilities (direct, portfolio, other, reserve assets) <p>Use of examples</p> <ul style="list-style-type: none"> • examples of credit and/or debit transactions in each category such as the export of iron-ore (goods credit), tourism travel overseas (services debit), interest payment on debt (income debit) • examples of credit and/or debit transactions in each category such as payment for copyright (capital debit) and purchase of an Australian share by a foreigner (financial account credit) <p>Australian references</p> <ul style="list-style-type: none"> • Current Account in deficit over last 10 years but fluctuating • Goods balance highly volatile • Services usually in deficit • Financial Account in surplus | |

- (b) Discuss the structural and cyclical reasons for recent (the last ten years) trends in Australia's current account. (12 marks)

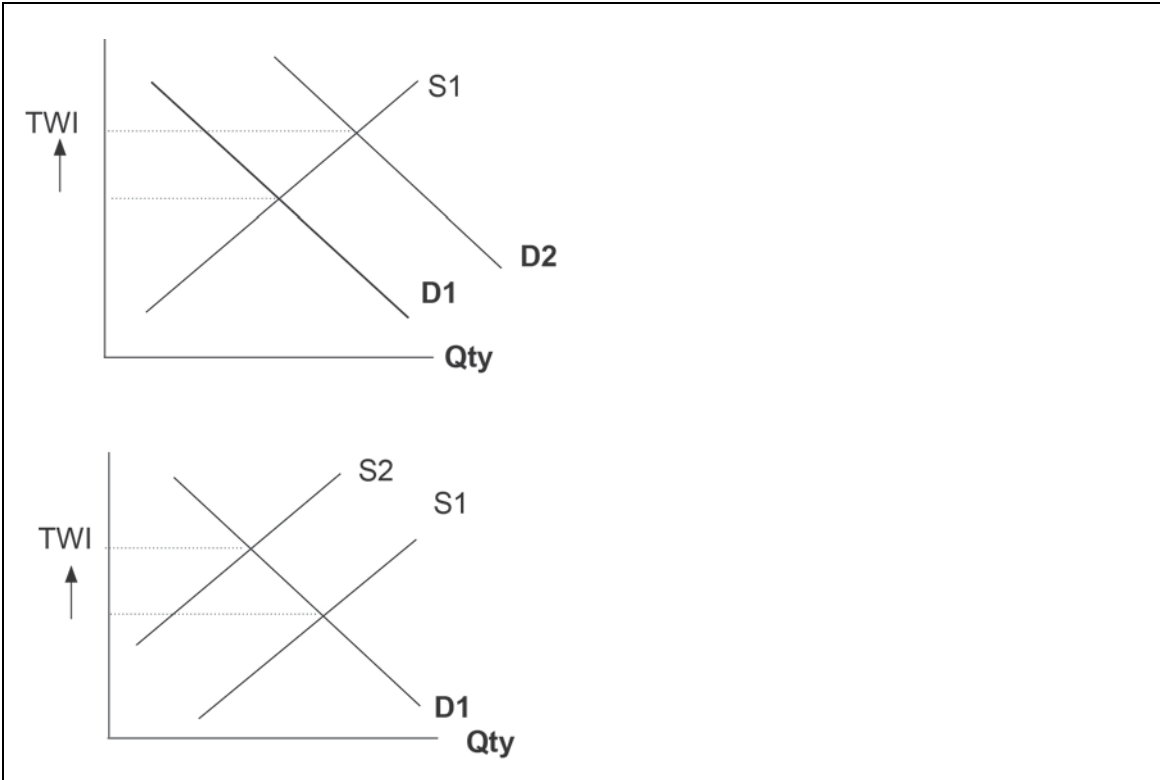
| Description | Marks |
|--|-----------|
| Trends | |
| Describes correctly the current account trends over the last 10 years. Uses appropriate data to support trends, i.e. % of GDP | 2 |
| Demonstrates some awareness of shifts in CAD since 2007 | 1 |
| Subtotal | 2 |
| Structural reasons | |
| Discusses in detail the link between the nation's saving–investment gap and reliance on foreign investment causing an ongoing net income deficit which ensures a CAD | 3–4 |
| Describes the importance of the net income section in determining the current account outcome | 1–2 |
| Subtotal | 4 |
| Cyclical reasons | |
| Discusses three reasons | 5–6 |
| Discusses two reasons | 3–4 |
| Discusses one reason | 1–2 |
| Subtotal | 6 |
| Overall total | 12 |
| <p>Answers could include but are not limited to:</p> <ul style="list-style-type: none"> • overseas business cycle, e.g. Australia's trade partners • domestic business cycle • terms of trade • exchange rate. | |

Question 29

(20 marks)

- (a) Explain how the trade-weighted index is calculated and, using a diagram(s), demonstrate and describe **two** causes of this change. (10 marks)

| Description | Marks |
|--|-----------|
| Explanation | |
| Explains what the TWI is and how it is calculated using examples of Australian trading partners as appropriate | 2 |
| Provides a limited explanation of the TWI | 1 |
| Subtotal | 2 |
| Identifies the change as an appreciation of currency | 1 |
| Subtotal | 1 |
| Provides a detailed description of the first cause of appreciation | 2 |
| Makes some link between a cause of change in the TWI and the effect | 1 |
| Subtotal | 2 |
| Provides a detailed description of the second cause of appreciation | 2 |
| Makes some link between a cause of change in the TWI and the effect | 1 |
| Subtotal | 2 |
| Diagram(s) | |
| Draws correct and fully labelled diagram(s) and shifts clearly linked to the description of the cause(s) | 3 |
| Draws correct diagrams | 2 |
| Makes some attempt to use demand/supply diagrams to show currency change | 1 |
| Subtotal | 3 |
| Overall total | 10 |
| <p>Answers could include but are not limited to:</p> <p>Explanation:</p> <ul style="list-style-type: none"> • TWI is a weighted average of a basket of currencies weighted according to their importance in trade flows with Australia • a more accurate reflection of demand and supply of currency than more common measures such as USD currencies • currencies of trading partners such as Yuan, Yen, USD, NZ dollar and Euro are included and weighted in the construction of the index • description of the causes of the appreciation of the AUD measured by the TWI reflects a number of factors such as: <ul style="list-style-type: none"> ◦ rising prices for commodity exports such as iron-ore and coal. This increases demand for AUD on the FOREX market from foreign purchasers ◦ decrease spending on imports will cause a decrease in supply of AUD ◦ any other reasonable answer <p>Diagram(s) demonstrates the appreciation by:</p> <ul style="list-style-type: none"> • the shift of the demand curve to the right and the shift of the supply curve to the left – both will cause an appreciation of the currency • the labelling of the diagram with D and S and change in AUD measured in TWI or exchange rate on vertical axis, Q on horizontal access <p>Note: reference to AUD required</p> | |



Question 29 (continued)

- (b) Discuss the likely effect of this movement in the trade-weighted index on the Australian economy. (10 marks)

| Description | Marks |
|--|-----------|
| Macroeconomic effects | |
| Discusses in detail the macroeconomic effects | 3 |
| Describes the macroeconomic effects | 2 |
| Identifies a macroeconomic effect | 1 |
| Subtotal | 3 |
| Nature of effects | |
| Recognises that there are positive and negative effects | 1 |
| Subtotal | 1 |
| Other effects | |
| Discusses three effects | 5–6 |
| Discusses two effects | 3–4 |
| Discusses one effect | 1–2 |
| Subtotal | 6 |
| Overall total | 10 |
| <p>Answers could include but are not limited to:</p> <p>Macroeconomic effects:</p> <ul style="list-style-type: none"> • contractionary effect • reduction in AD • reduced employment • falling price levels • falling GDP/income. • <p>Other effects:</p> <ul style="list-style-type: none"> • may cause an increase in a trade deficit (or a reduction in trade surplus) – Australian exports become more expensive and the price of imports falls, harming domestic producers (although capital import costs will fall) but beneficial to domestic consumers • service balance may decrease as more Australians are encouraged to travel overseas and less tourists come to Australia; the nation also becomes less attractive as an education services exporter • reduction in net exports may increase the CAD • servicing of foreign debt may also become easier as the dollar strengthens (depending on the currency it is held in) • RBA may be concerned that a strengthening dollar does not support the transition away from the mining boom and may take action to reduce the cash rate to limit the inflow of funds and keep the dollar down • decrease in import prices reduces inflation • effect on consumers – increased spending power • effect on exporters – decreased competitiveness. | |

Question 30

(20 marks)

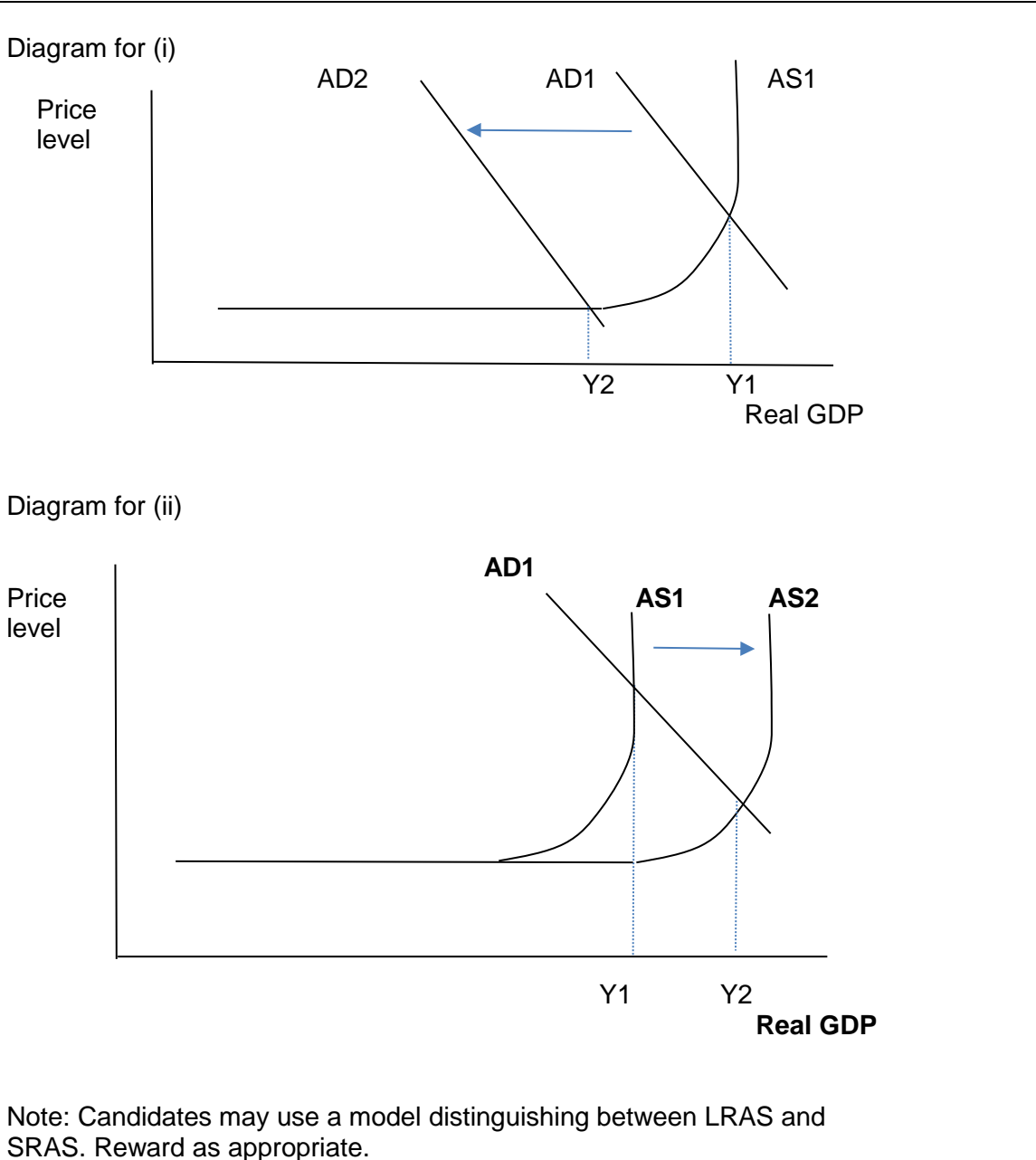
- (a) Discuss the extent to which the Australian Government has achieved its economic objectives in 2016–2017. (10 marks)

| Description | Marks |
|---|-----------|
| Price stability | 2 |
| Price stability: statement of correct objective | 2 |
| Discusses the extent of achievement with reference to current data | 1 |
| Statement of objective but limited detail regarding current situation | 1 |
| Subtotal | 2 |
| Economic growth | 2 |
| Economic growth: statement of correct objective | 2 |
| Discusses the extent of achievement with reference to current data | 1 |
| Statement of objective but limited detail regarding current situation | 1 |
| Subtotal | 2 |
| Full employment | 2 |
| Full employment: statement of correct objective | 2 |
| Discusses the extent of achievement with reference to current data | 1 |
| Statement of objective but limited detail regarding current situation | 1 |
| Subtotal | 2 |
| Other objectives (may be embedded in above) | 2 |
| Discusses other objectives such as equitable income distribution and efficient resource allocation with reference to current data | 2 |
| Statement of objective but limited detail regarding current situation | 1 |
| Subtotal | 2 |
| Macroeconomic influences (may be embedded in above) | 2 |
| Discusses a range of factors that have influenced the government's ability to meet the economic objectives | 2 |
| Identifies some factors that have influenced the macroeconomy | 1 |
| Subtotal | 2 |
| Overall total | 10 |
| <p>Answers could include but are not limited to:</p> <p>Objectives:</p> <ul style="list-style-type: none"> • price stability – (2–3% change in CPI on average over the course of the business cycle) and current result; within the RBA target range there was some concern about deflation early in the year • sustainable economic growth (3–4% growth in real GDP); currently below trend growth – quarterly variation • full employment: currently just above the target range; evidence of some cyclical; concern about level of hidden unemployment and underemployment that indicate the 'real' level is even greater • equitable allocation of income/efficient resource allocation; lack of productivity policy development and below trend economic growth limiting achievement • extent and possible factors influencing achievement: <ul style="list-style-type: none"> ◦ low levels of investment, consumer and business sentiment ◦ political instability ◦ concerns (or not) over Chinese growth. | |

- (b) Using the aggregate demand and aggregate supply (AD/AS) model, demonstrate and explain the likely impact on the Australian economy of each of the following events:
- (i) a Chinese economic recession
- (ii) a sustained rise in Australian labour productivity. (10 marks)

| Description | Marks |
|---|-----------|
| Chinese economic recession | |
| Explains in detail the contractionary impact on the economy (due to falling net exports and investment), discussing a range of economic indicators i.e. growth, inflation, unemployment, trade balance, exchange rate, terms of trade | 2–3 |
| Explains the contractionary impact, discussing some economic indicators | 1 |
| Subtotal | 3 |
| AD/AS model | |
| Provides a diagram correctly-drawn and fully-labelled showing the AD curve shifting to the left resulting in a fall in real GDP and less price pressure The diagram links to the description | 2 |
| Provides a diagram showing the correct shift in the AD curve The diagram is not fully-labelled or linked explicitly to the description | 1 |
| Subtotal | 2 |
| Sustained rise in Australian labour productivity | |
| Explains in detail the expansionary impact on the economy (due to decreasing costs), discussing a range of economic indicators i.e. sustainable growth, lower inflation, unemployment, trade balance, international competitiveness | 2–3 |
| Explains the expansionary impact, discussing some economic indicators | 1 |
| Subtotal | 3 |
| AD/AS model | |
| Provides a diagram correctly-drawn and fully-labelled, showing the AS curve shifting to the right resulting in an increase in real GDP without significant price pressure Links the diagram to the description | 2 |
| Provides a diagram showing the correct shift in the AS curve The diagram is not fully-labelled or linked explicitly to the description | 1 |
| Subtotal | 2 |
| Overall total | 10 |

Question 30 (continued)



Question 31

(20 marks)

In February 2014, the Reserve Bank of Australia (RBA) cash rate was 2.50%. In February 2017, it was 1.50%.

- (a) Explain how the transmission mechanism would operate to affect the level of economic activity because of this monetary policy stance. (12 marks)

| Description | Marks |
|---|-----------|
| Cash rate | |
| Identifies the monetary policy as expansionary | 1 |
| Provides a reason for the stance | 1 |
| Identifies the flow on effect to market interest rates | 1 |
| Subtotal | 3 |
| Transmission mechanism | |
| For each of three components: | |
| Provides a detailed explanation of how the component affects the level of economic activity | 3 |
| Provides some explanation of how the component affects the level of economic activity | 2 |
| Identifies a correct relationship between the component and the level of economic activity | 1 |
| Subtotal | 9 |
| Overall total | 12 |
| <p>Answers could include but are not limited to:</p> <p>Cash rate:</p> <ul style="list-style-type: none"> • loose or expansionary policy stance • below trend growth • market interest rates should fall. <p>Transmission mechanism:</p> <ul style="list-style-type: none"> • saving, consumption and Investment decisions – reduced incentive to save and a greater incentive to borrow by households and firms as there is a reduction in cost of borrowed funds; overall consumption and investment should rise • improved cash flow – a reduction in interest rates increases the amount of income available to spend; for firms, more cash being available means they are more likely to expand production or increase employment • wealth and asset prices – shares are more attractive than deposits in financial institutions and bonds, so the stock market may rise and increase wealth, encouraging spending; asset prices, particularly housing may also rise because of greater demand increasing people's wealth • exchange rate – fall in rates reduces capital inflow, reducing demand for currency and leading to a depreciation of currency; this might lead to improvement in the net exports and raise total spending. | |

Question 31 (continued)

- (b) Describe
- two**
- strengths and
- two**
- weaknesses of monetary policy. (8 marks)

| Description | Marks |
|--|----------|
| Describes monetary policy strength one | 2 |
| Identifies monetary policy strength one | 1 |
| Subtotal | 2 |
| Describes monetary policy strength two | 2 |
| Identifies monetary policy strength two | 1 |
| Subtotal | 2 |
| Describes monetary policy weakness one | 2 |
| Identifies monetary policy weakness one | 1 |
| Subtotal | 2 |
| Describes monetary policy weakness two | 2 |
| Identifies monetary policy weakness two | 1 |
| Subtotal | 2 |
| Overall total | 8 |
| <p>Answers could include but are not limited to:</p> <p>Strengths:</p> <ul style="list-style-type: none"> flexibility – monthly decision-making on cash rate settings political independence – RBA is not aligned to the government in power so decisions are made on economic and not political grounds not targeted at particular groups in society effective in a boom because higher interest rates have a large influence on economic decisions interest rate changes work in tandem with the exchange rate. <p>Weaknesses:</p> <ul style="list-style-type: none"> effect lag for monetary policy is long less effective in a recession where sentiment outweighs low rates monetary policy is a blunt policy instrument. | |

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