



Units 3 and 4 Economics

Practice Exam Solutions

Stop!

Don't look at these solutions until you have attempted the exam.

Any questions?

Check the Engage website for updated solutions, then email practiceexams@ee.org.au.

Section A – Multiple-choice questions

Question 1

The correct answer is B.

Question 2

The correct answer is C.

Question 3

The correct answer is A.

Question 4

The correct answer is D.

Question 5

The correct answer is C.

Question 6

The correct answer is C.

Question 7

The correct answer is C.

Question 8

The correct answer is D.

Question 9

The correct answer is B.

Question 10

The correct answer is C.

Question 11

The correct answer is D.

Question 12

The correct answer is A.

Question 13

The correct answer is A.

Question 14

The correct answer is C.

Question 15

The correct answer is C.

Section B – Short-answer questions

Question 1a

A number of budgetary policies can be referred to. Students must make sure they select a policy from either this year's or last year's budget. A clear link between the policy and the way it acts to achieve equity in income distribution needs to be made.

Students should look to the Government's Budget website for up-to-date policy announcements:

<http://www.budget.gov.au/2013-14/index.htm>

Question 1b

A number of budgetary policies can be referred to. Students must make sure they select a policy from either this year's or last year's budget. A clear link between the policy and the way it acts to improve international competitiveness needs to be made.

Question 1c

Possible impacts on living standards of failing to meet the goal of equity in income distribution:

- Some citizens would not have access to basic goods and services
- Inequity reduces access to education and healthcare which creates long-term ramifications for a society
- Inequality amongst citizens would create unhappiness and social disorder

Possible impacts on living standards of failing to meet the goal of full employment:

- Less people will receive factor incomes, reducing their ability to consume goods and services
- Increases the strain on the federal government's budget outlays, resulting in difficult trade-offs and inevitable public spending cuts
- Being unemployed reduces self-esteem, worsens health, and leads to feelings of exclusion

Remember to always relate these negative effects back to living standards. Differentiate between material and non-material standard of living.

Question 2a

An example of a high-scoring response:

In order to slow inflation during an upturn, the RBA can implement a contractionary monetary policy stance which involves increasing interest rates. The RBA achieves this by first announcing a rise in the cash-rate target, providing a detailed explanation of its reasons (for example, unfavourable inflation figures may have been released). It then aims to achieve this target by using open market operations to sell government securities at a discounted rate. This makes government securities more attractive to financial institutions because, when purchased at a lower price, their yield would rise, giving owners a better rate of return on their investment. In exchange for receiving government securities, financial institutions then transfer money to the RBA, thus reducing money supply held by these institutions in their Exchange Settlement Accounts. In order to top up their Exchange Settlement Accounts to the minimum required level, financial institutions must compete for available credit in the short-term money market. Moreover, there is reduced supply of money to be borrowed in the short-term money market. As a result, the cash rate increases towards the announced target. When the cash rate increases, other medium and long-term interest rates in financial markets will also increase.

Question 2b

The general trend of monetary policy over the last three years is as follows:

2011-2012: strong recovery from the GFC as a result of the mining boom and highly expansionary monetary and budgetary policy. As a result of strong growth and rising inflation, the RBA held the interest rate at 4.75 per cent for most of 2011.

2012-2013: By mid-2012 concerns over the mining boom ending and prolonged economic problems in Europe and the US reduced confidence in Australia and slowed inflation. As a result, the RBA decreased the interest rate from 4.25 per cent in April 2012 to 2.75 per cent in May 2013.

2013-2014: Growth has been slow over the past year, with low confidence playing a key role in the RBA's decision to hold the cash rate at a low of 2.50 per cent. However, with inflation starting to pick up, we may see the RBA move from an expansionary to a neutral stance in the coming months.

To gain full marks for this question, students must evaluate how effective these measures have been in achieving the government's goals of full employment, low inflation and strong and sustainable economic growth.

Question 2c

Possible consequences of an ageing population include:

- Reduced taxation revenue for the government
- More strain placed on the working population
- Heavy strain on public healthcare system
- Increased pension payments, resulting in difficult trade-offs for government spending

Question 2d

One possible aggregate supply policy is an increase in skilled immigration. One possible aggregate demand policy is a private healthcare incentive scheme. A number of other policies are also possible.

Question 3a

To gain full marks for this question, students must explain *why* the government wants to bring the budget back to surplus, not *how* the government would go about doing this.

- There is a stated budgetary policy objective, which is to balance the budget in the medium term
- Moving the budget back to surplus is needed to take pressure off interest rates so that the public sector is not competing to borrow money within the private sector.
- There is a need to maintain confidence in the management of the Australian economy. This would act to maintain international investor confidence.

Question 3b

A range of responses could be acceptable for this question. Any policy which acts to increase revenue or decrease outlays will be sufficient to gain marks for this question.

Question 3c

A high-scoring answer will explain that relative scarcity is about there being limited resources (land, labour, capital and enterprise) in relation to satisfying society's unlimited wants.

Question 3d

An example of a high-scoring response:

In a competitive market economy, consumers are sovereign and send signals to suppliers on how resources should be allocated through their demand for particular products. Prices of goods and services may fluctuate depending on changes in the conditions of demand and supply. As firms are motivated by profit, the final price received by firms for a particular good or service will ultimately determine how productive land, labour and capital resources are allocated. In order to minimise costs of production, scarce resources will not be allocated to production that is unprofitable. Therefore, there will be a shortage in the market, as demand exceeds supply, resulting in an increase in the price toward a new equilibrium where supply matches demand again.

Question 4a

Variations on:

The market is usually a very effective way of allocating resources. However, sometimes it fails to allocate resources in the most efficient way or it causes some undesired outcome for society. That is, it may diminish standard of living, material or non-material. This is called Market Failure. One example of market failure is the existence of negative externalities such as pollution which arise out of production.

Question 4b

Answers will vary depending on which market failure was discussed in part a.

Question 4c

Possible microeconomic reform policies which could be discussed include:

- Labour market reform
- Skills initiatives
- Productivity initiatives
- Trade liberalisation

To gain full marks students must explain *how* these policies act to bring about improvements in the government's goal of external stability.

Question 4d

Factors which may have contributed to a drop in the value of AUD include:

- Historically low interest rates
- Increasing global confidence that the US is behind the worst of its downturn
- Reduced demand from China for our mining exports
- Falling commodity prices

Question 4e

Groups which benefit from a high AUD:

- Australians who import products from overseas
- Australian tourists travelling overseas
- The mining industry (due to inelastic demand)

Groups which suffer from a high AUD:

- Manufacturing, agricultural, tourism and education exporters
- Australians wanting to travel overseas
- Overseas countries wishing to sell their products to Australians