2021 ASSESSMENT REPORT
ECN315116 - ECONOMICS

Section A

Question 1

Many students provided background about the operation of the market mechanism which leads to market failures. While relevant it did not add value to the answer that was required. In some answers more than a third was written about this taking up valuable space and time addressing the question. Stronger answers provided concrete strategies that governments use to address insufficient and undesirable quantities, like the provision of goods and services by governments, taxation and subsidies to regulate consumer and business behaviour.

Suggested Content

- Some mention of market failures in terms of unfavourable outcomes:
- Provision of goods and services by Governments of public goods, merit goods (health education etc.), collective goods (defence, national parks etc), natural monopolies (NBN)
- Governments can encourage private providers of public goods like roads, prisons and other outsourced services.
- Abuse of market power - governments can regulate unfair trade practices and discourage monopolies and encourage competition.
- Regulation to prohibit certain goods (drugs etc)
- Government transfer payments when the economic cycle declines.

Question 2

Many students provided in-depth discussion about elasticity without making reference to the revenue earned using the Total Outlay method. Better answers provided suitable examples to explain the characteristics of elasticity in more detail.

Ideally students should write a third on the concept of inelasticity and a third on each of the characteristics.

Suggested Content

- Price inelasticity of demand measures the responsiveness of quantity demanded to changes in the price of a good or service. When prices are raised and the revenue increases (according to the Revenue method) then the product / service is said to be inelastic.
- Important for businesses and governments to have this information to decide on the optimal pricing and taxing strategies.

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- Characteristics of elasticity:
  - Good is a luxury or necessity - bread milk vs dining out or expensive watch
  - Good has close substitutes - e.g. brand of food
  - Expenditure on the product as a proportion of income - e.g. car.
  - Length of time to change product - car
  - Good is addictive or not (cigarettes)

Question 3

Many students included a circular flow diagram, which was not necessary to gain full marks if the answers addressed each of the three leakages in detail. It was important to detail how each leakage reduced consumption by consumers and the resultant contractionary impact on future economic growth, employment and income.

Better answers pointed out the relationship of each leakage with the corresponding injection.

Suggested Content

- Bank sector - leakage of savings. Savings are monies put aside out of the circular flow by consumers for a future purpose. This represents an opportunity cost in resent consumption which reduces the level of economic activity. When consumers decide to change their level of savings then economic activity will decline if income stays constant. Increased savings will provide a bigger pool of money to be lent out by banks as investment expenditure by businesses, increasing long term economic growth as the productive capacity of the economy grows.
- Government sector - taxation is a leakage from the circular flow. Increased tax means less disposable income for consumers and businesses causing a decrease in economic activity, with resulting falls in income, output and employment opportunities. With increased taxation, more government spending could occur and debt levels be reduced.
- International sector - leakage of imported goods and services that goes overseas out of circulation in the Australian economy. Increased imports cause a decrease in Aggregate Demand and economic activity with decreasing levels of income, output and employment opportunities.

Question 4

This question on Fiscal Stance was answered very well. Most students were able to incorporate the term 'Fiscal Stance' into a broader explanation of Fiscal Policy and the various roles/aims of Fiscal Policy. In explanations of both Expansionary and Contractionary, better answers discussed:

- the economic reasons and problems that each stance were addressing
- the required changes in government expenditure and taxation collections
- how the changes in G or T would flow through to impact on Aggregate Demand and economic growth

- specific examples from recent years to help explain the different stances. For example, expenditure and taxation measures from the 2020/21 budgets and the winding down of expenditure measures in the 2021/22 budget.

Suggested Content

- Define fiscal policy or ensure that fiscal stance is explained in a broader context.
- The different types of stance need to be explained. Some students will also mention a neutral stance.
- Each stance should be defined and explained. That is, the impact of the stance on levels of economic activity.
- Expansionary: a smaller surplus or bigger deficit relative to the previous year. The role of fiscal policy is to stimulate economic activity during periods where C, I and X may be experiencing weak growth, that is, not enough growth to sustain acceptable levels of employment. Expansionary policy can include an increase in G and/or a decrease in T relative to the previous year's budget.
- Contractionary: opposite to the above.

Question 5

This was a hard question as some students were not fully prepared for the specific content required. Knowledge of the different types of unemployment was needed, especially the link between cyclical unemployment and the Natural Rate of Unemployment, which is regarded as the rate of Full Employment. Although related to underutilisation of labour, many students only discussed Hidden and Underemployment in the context of why these types of unemployment are not reflected in the unemployment rate.

Suggested Content

- Define what it means to be employed. Define what is meant by unemployment.
- At the peak of the business cycle, when cyclical unemployment has dissipated, there will still remain other forms of unemployment meaning that unemployment will not get to 0% due to the existence of frictional, seasonal, long term and structural unemployment.
- In addition, due to the significant amount of underemployment of labour in Australia many employed are seeking more hours. As a result the level of unemployment has fallen in recent years without adding to inflationary pressures, that is, there has been no resultant increase in wages and hence a lack of related cost push inflation.
- During the pandemic there was also a significant increase in hidden unemployed, hiding the true unemployment statistic.

Question 6

This question could be interpreted in two ways - "a slowdown in economic activity" and "to slow economic activity". Students were acknowledged for both responses, and in fact many explained both situations. Most students defined accurately what an automatic stabiliser was. However, answering this question was difficult for the students who were not able to discuss the mechanics of how progressive taxation and welfare payments are able to automatically lessen the upturns and downturns of the business cycle. Many students just stated that the government increases welfare payments and decreases taxation in a downturn, without an explanation. Better answers also provided a diagram of the business cycle showing the impacts with and without auto stabilisers.

Suggested Content

- Definition of fiscal policy with an explanation of what an automatic stabiliser is in the context of fiscal policy.
- In terms of a slowing economy (a downturn), automatic stabilisers will assist the economy to avoid a downturn in economic activity turning into a recession. As the economy experiences a decrease in C, I and possibly X, in a downturn, non-discretionary measures with-in the budget will automatically adjust government spending (injections) and tax receipts (leakages). An economic downturn results in an increase in unemployment, but automatic stabilisers will ensure that welfare payments are provided to those recently unemployed, so rather than incomes falling to zero, the welfare payment will assist the unemployed to continue consuming, hence slowing down the rate of the economic downturn. In addition, less leakages from tax receipts occur when an income earner finds themselves unemployed.
- Automatic stabilisers on their own will not be sufficient to avoid an economic downturn and the government will also adjust their fiscal stance accordingly, most likely implementing expansionary fiscal policy measures.

Question 7

Most students were able to accurately define the principles of comparative advantage and free trade. Better answers integrated these concepts to discuss how free trade is helpful if economies are to focus on resource allocation based on comparative advantage. Without free trade the benefits of focusing on comparative advantage would be diminished were explained.

Any two reasons, with explanation, why a government could justify a trade protection measure were accepted. Better answers detailed the benefits obtained, or disadvantages avoided, that the trade protection measure provided. For example, protection of an infant industry with subsidies or tariffs may be necessary in order for the industry to develop the required efficiencies and economies of scale to compete with established global businesses.

Suggested Content

- Free trade should be defined as this gives the required context for a discussion of comparative advantage. Students may possibly mention "trade liberalisation".
- Comparative advantage needs to be defined and explained. Some students will give an example of comparative advantage that an economy may enjoy.
- An explanation of the benefits of adopting the principle of comparative advantage, and how free trade encourages economies to focus upon comparative advantage, will need to be provided in order to address the first part of the question
- Examples of why a government may still wish to restrain free trade include:

- To protect domestic employment from imports that may provide more choice, may be cheaper and better quality
- The self-sufficiency argument (as was highlighted during the pandemic with a shortage of respirators)
    - To allow infant industries to establish themselves to compete internationally.
    - To prevent dumping by other economies of surplus production
    - To protect infant industries

Question 8

This question was well done. Better answers also supplied Demand and Supply diagrams to assist with their answer. This was a good question for students to supply a well-researched definition appropriate to our course. Better responses explained what an appreciation was and that this could occur with either an increase in demand or a decrease in supply of the $AUS. Better answers also indicated that in most cases the demand and supply of the $AUS was derived from the purchase or sale of a good, service, asset or financing transaction. Reward was given to students who provided two distinctive examples, in contrast to, two examples of an increase in the demand for the exports of goods.

Suggested Content

A floating exchange rate is one which is set by the free interaction of supply and demand in the market for the currency. Australia has such an approach to establishment of the exchange rate for the A$.

Therefore the exchange rate (price of A$ in terms of another currency) will appreciate (increase) when there is an increase in demand for the currency or a decrease in supply.

Two factors that may cause an appreciation. Select from:

- Increase Australian interest rates relative to overseas interest rates
- Increase in exports, particularly commodity exports like iron ore and coal. Can be due to increased international competitiveness and changing tastes and preferences.
- Reduction in imports.
- Increased interest in Australia as an investment opportunity
- Changes in global economic conditions will influence exports and imports.
- Speculators who expect an upward movement in currencies.

Question 9

Most students were able to provide an accurate explanation of globalisation. The second part of the question was difficult in that it asked students to link their respective "aspect of globalisation" to how this aspect contributed to free trade. Students who accurately did this were rewarded. Most students correctly explained two aspects of globalisation. For better marks, students are encouraged to add more detail or evidence as to how the "aspect" has contributed to enhancing the global economy. For example, some students under the heading of Technology & Transport, discussed the importance of shipping and containerisation in enabling large quantities of goods to be efficiently transported around the globe, delivering the respective goods that an economy has comparative advantage in producing.

Suggested Content

- *According to WHO*, globalisation can be defined as "the increased interconnectedness and interdependence of peoples and countries. It is generally understood to include two inter-related elements: the opening of international borders to increasingly fast flows of goods, services, finance, people and ideas; and the changes in institutions and policies at national and international levels that facilitate or promote such flows."
- Globalisation is the situation where barriers between nations are broken down and business and other activities are carried out on a whole world scale. In terms of Economics it relates more specifically to the removal of barriers to free trade, the flow of investment funds, the internationalization of supply chains and the movements of labour.
- TWO aspects:
  - Trade in goods and services to countries that allow access to resources that are limited in their own country, provide more goods and services to other countries that are not produced in their own country at a lower cost.
  - Financial flows between countries to allow economic development. Includes currency and capital and finance flows.
  - Foreign investment in other countries by transnational corporations.
  - Movement of labour between countries to allow labour demands to be satisfied in other countries by in terms of immigration and skilled labour shortages.
  - Technology assists globalisation in terms of communication, transport and transfer of ideas.

Section B

Question 10

Most students successfully worked out the opportunity cost, however some answered per unit rather than as the question specified, that is moving from point A to point B. There were a range of answers for part two of the question, the majority of students clearly indicated that point C was above the current possibility and then went on to demonstrate a range of skill levels in their explanation of why this was the case.

Question 11

Mainly well answered, however, some students did not correctly interpret what was meant by a range of prices. The total revenue needed to be calculated for each price to determine the price range for which demand was elastic or inelastic. Some students spoke of profit without any mention of revenue in the third part of the question.

Question 12

Few students did well on <u>all</u> aspects of this question. Common faults were poor diagrams, failure to clearly demonstrate the effect on price and quantity and the absence of any explanation. Marks were awarded for those who misunderstood part i and commented on a decrease in supply rather than an increase in demand. While some students attempted to draw all 3 changes on the one graph, it would be better to draw separate graphs for each of the changes.

Question 13

This was not a popular question. It was surprising that many students were unable to correctly calculate GDP, mistakes included adding taxation receipts, multiplying rather than adding and adding rather than subtracting imports. Students that did well in the second part of the question drew a circular flow diagram and referred to the tendency for equilibrium between leakages and injections.

Question 14

This question was very popular and with the use of wording and data students gave good descriptions of the cash rate target trend. Most students recognised that this was an expansionary trend and backed up their classification with adequate explanations of the workings of expansionary monetary policy.

Question 15

Once again it was surprising to see that some students were unable to remember correct formulae, a common mistake was for students to use the current year rather that figures for the previous year as a denominator. Many students correctly identified the preferred rates for inflation and economic growth. Most students successfully spoke of the issues associated with high inflation, but many students made no comment on the high rate of economic growth.

Question 16

Students generally had the right idea in regard to a depreciation of the Australian dollar against the US dollar. However, some students lost track of the facts of the question and started to use other currencies, such as Euros in their explanations. Many students focussed on an increase in imports, another possible reason for the increase in supply may have been an increase in Australian investment overseas. Some students unnecessarily complicated their answers by discussing demand factors.

Question 17

Few students answered this question. Good answers identified that equities and debt both contribute to liabilities. Many spoke of the debt trap scenario described in the textbook. Students that scored highly did so because they gave clearly worded explanations and spoke of the decrease in the 2020 figure for equity.

Question 18

Most of the answers to this question were of a very high standard. The students that did particularly well not only gave good definitions and explanations, but additionally displayed a good understanding of current conditions by providing comments such as "the rise of Asian economies", "the Eurozone", and "the dwindling influence of the United Kingdom as a trading partner".

Section C

Students should note that the marks allocated to questions in this section vary and should allocate time accordingly.

Question 19

a) Students identified the inflation and employment goals effectively and many commented on the current rates. The second part of the question proved more difficult and often students did not analyse the **link** between the level of employment, wages growth and inflation. It would have been useful for students to discuss aggregate demand and thus lead into a more obvious discussion about the link between the three. In addition, it would also have been useful to distinguish the types of inflation. Strong wages growth will, for example, lead to cost push inflation.

A macro diagram showing increased AD or decreased AS would also have contributed to answers.

b) Some students missed the point of this question, whilst others provided clear responses. Students needed to recognise that if monetary policy was used to address increasing house prices, thus an increase in the cash rate, this would lead to a decrease in AD and thus have a negative impact on unemployment and inflation if levels were low.

c) A straight forward question. Answers needed to provide two impacts of unemployment upon **individuals**. Some students overlooked that the impacts they described should be on individuals e.g. Living standards, long term unemployment, loss of skills, mental health, crime etc.

d) The questions required students to describe the transmission mechanism, making it clear how monetary policy could influence components of AD and hence employment and inflation. Quite a few answers did not mention AD (question needs to be read carefully). Mentioning the type of inflation likely to be generated was also valuable. A diagram would be useful.

NB – it is wise not to use the term 'investment' when referring to individuals/households.

e) Responses were mixed to this question. Some students discussed the impacts of having an inflation range between 2-3%. Whilst merit could be given, stronger answers focussed on the implications **of the policies** required to bring inflation consistently to this level. Students are encouraged to separate positive and negative clearly.

f) Pros and cons depended upon whether students were discussing inflation above or below the target. Some implications included impact on savers (e.g. retirees), those on fixed incomes, borrowers, home buyers and owners etc.

g) Most students identified two recommendations. Some failed to distinguish what might be short term as opposed to long term, for example, some considered housing projects short term. Short term examples include first home buyer grants, rent controls, reducing building regulations etc. Long term examples could include fiscal measure supporting housing supply, social housing, tax reform etc.

Question 20

a) The question was answered well, however again, students need to distinguish costs and benefits rather than letting their answer 'run together'. Benefits to the government tended to be overlooked. Benefits may be increased production levels, increased tax receipts, higher incomes, lower unemployment etc while costs include inflationary pressures (demand pull and cost push), rising house prices, growing inequality.

b) Similarly, to 19 (b), some students missed the point of the question. Merit was still given to different approaches. Best answers identified that inflation that was 'too low', reflected low aggregate demand. Students could then go on to discuss this and explain that there was little room to use further monetary policy.

c) It was pleasing to read where students considered both positive and negative social justice implications. Most considered negative only, however they could still gain full marks for this. As low inflation is associated with low interest rates, this has different effects on different groups in society e.g. retirees, home buyers, investors etc.

d) Students responded well to this question and a clear understanding of how a deficit stimulates the economy was quite strong. Better answers made reference to AD and thus increases in C and I due to fiscal policy and reference to leakages and injections was also valuable. Students should have mentioned AD and possibly used a diagram, thus clearly expressing how it addresses low inflation and possibly the type of inflation it addresses.

e) Some responses were too general. Comparison to Monetary Policy often useful. Advantages included that it could be targeted, can have immediate impacts etc.

f) This question was well answered in terms of identifying limitations. Further discussion on the consequence of debt such as a drag on future growth and the burden on future generations would have ensured stronger marks.

Question 21

a) This question related to the surplus in the trade balance and deficits in the primary and secondary income balances. Students were not expected to include discussion on the secondary income balance but given this was an 8-mark question, a reasonable level of detail on the trade balance and primary income was required for full marks. Many strong students referenced the stimulus piece and expanded on this, with discussion about Australia's recent commodity exports and some students mentioned the unprecedented fall in tourism imports. Students who discussed the net primary income balance in the context of historic foreign investment due to previous deficits in the Current Account tended to score well

b) Students were required to identify and discuss 2 issues for the Australian economy resulting from trade disruptions. Markers accepted a wide range of interruptions including falls in tourism, international students, trade issues with China and problems with international supply chains. Students were then expected to discuss how this would create issues for the Australian economy. Answers such as the impact on the trade balance and current account, impacts on unemployment, changes to aggregate demand as well as shortages and potential price rises were examples of some of the issues students discussed.

c) Costs associated with high levels of foreign ownership in the mining industry included profits flowing offshore, deficits on the net primary income account and foreign-based decision makers not taking into account local issues associated with employment and the environment. The main benefit mentioned was the additional investment that would not occur otherwise, with the employment and taxes associated with this. As this was a four-mark question, markers did not expect detailed responses.

d) Students were expected to describe the circumstances under which foreign liabilities are not necessarily a concern. The main point mentioned in stronger answers was that foreign liabilities, if due to foreign investment in productive enterprises, was likely to make Australia more productive, improve employment, generate taxes and boost GDP and the growth in foreign liabilities would not be a concern. Students may have discussed how liabilities as a percentage of GDP was a more important measure, but this was not expected.

e) The main social justice issues arising from a high level of foreign debt mentioned by stronger students were the issue of debt repayments. Some students talked about rising levels of inequality potentially resulting from a nation of workers employed in the service of foreign employers. The main environmental issue discussed was that Australian businesses may invest in countries with more relaxed environmental regulations, resulting in increased pollution in other countries.

f) As a four-mark question, extensive detail was not required. Students who discussed how higher levels of domestic savings would reduce the need for borrowing from overseas were rewarded with better marks. Several students gave the example of the growing pool of superannuation savings in Australia resulting in Australia becoming a net owner of foreign assets.

Question 22

a) A wide range of issues associated with an appreciating Australian dollar were accepted. Many of the better responses discussed broad economic impacts as well as specific issues. Broader issues such as falling net exports and the impact on aggregate demand and therefore GDP, as well as impacts on the current account balance. Specific issues included impacts on employment in particular industries such as the tourism sector and mining. As an 8-mark question, more than one issue was required, and examples were helpful in demonstrating student understanding.

b) This was a quite specific question on the role that prices of commodities played in the value of the Australian dollar. Some students discussed how higher prices would reduce demand for commodities from Australia, thus depreciating the Australian dollar and while some credit was given for this, better answers understood that a world price holds for most commodities and that higher prices require overseas buyers to purchase more Australian dollars than previously, driving up demand and therefore appreciating the Australian dollar. Graphs were included in many answers and these aided communication as long as axes were labelled correctly and it was clear how the graph related to the written response.

c) As a 4-mark question less detail was expected for this question, but many students wrote relatively lengthy answers which may have been better spent on other questions. Students were rewarded for both positive implications, such as the price of imported goods falling thereby reducing some cost-of-living pressures, as well negative implications, such as the loss of employment in export and import competing industries.

d)
i. This question was well answered by most students who argued that a lower cash rate would reduce other interest rates in the economy, making Australia a less attractive investment destination. This would result in a fall in demand for the Australian dollar from foreign investors as well as a potential increase in supply as foreign investors sell Australian assets and Australian investors look overseas for investment opportunities.

ii. Most students explained that a depreciating Australian dollar would raise the price of imports and make exports more competitive, with stronger answers giving additional detail and examples.

e) Students generally did a good job at identifying and explaining 2 impacts of a depreciating dollar on the current account. Most discussed the impact on net exports. The impact on the net primary income account was also widely discussed, most often in the context of a rising net primary income deficit due to increases in repayments of foreign debt. Other interpretations were given credit according to the strength of the economic arguments used by students.

f) A depreciation would make exports more attractive and boost import competing industries. Policies to achieve this could include trade protection policies, microeconomic reform, infrastructure development etc. As a 4-mark question a full evaluation of these policies was not required.