 ECONOMICS UNIT 2

Economics Unit 2 practice exam 2018 and suggested answers

SCOTT JAMES | Caulfield Grammar School

The following practice exam covers the three areas of study in Unit 2 of the *VCE Economics Study Design* (2017–2021).

The practice exam consists of 15 multiple-choice questions (Section A) and nine written-response questions (Sections B–D).

Note that Section A covers Areas of Study 1 and 2 only. Section B draws on the key knowledge and key skills outlined in Area of Study 1 in Unit 2. Sections C and D draw on the key knowledge and key skills outlined in Areas of Study 2 and 3, respectively.

Additional space is available at the end of the question and answer book.

The practice exam and suggested answers are based on the author's interpretation of the *VCE Economics Study Design*.

Teachers are advised to preview and evaluate all practice exam material before distributing it to students.

Name: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Teacher: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

ECONOMICS UNIT 2

**Practice written examination 2018**

**Reading time: 15 minutes**

**Writing time: 2 hours**

**Question AND ANSWER book**

**Structure of book**

|  |  |  |  |
| --- | --- | --- | --- |
| *Sections* | *Number of questions* | *Number of questions to be answered* | *Number of marks* |
|  A B C  D  | 15324 | 15324 |  15 25 20 15 **Total: 75** |

* Students are permitted to bring into the examination room: pens, pencils, highlighters, erasers, sharpeners and rulers.
* Students are NOT permitted to bring into the examination room: blank sheets of paper and/or white-out liquid/tape.
* No calculator is allowed in this examination.

**Materials supplied**

* Question and answer book
* Answer sheet for multiple-choice questions
* Additional space is available at the end of the book if you need extra paper to complete an answer. Clearly label all answers with the appropriate section and question number.

**Instructions**

* Write your name and your teacher’s name in the spaces provided above on this page, and on the answer sheet for multiple-choice questions.
* The multiple-choice questions in Section A are to be completed in pencil on the sheet provided.
* All written-response questions are to be completed in blue or black pen in the spaces provided.
* All written responses must be in English.

Students are NOT permitted to bring mobile phones and/or any other unauthorised electronic devices into the examination room.

Section A: Multiple-choice questions

**Instructions for Section A**

Answer **all** questions in pencil on the answer sheet provided for multiple-choice questions.

Choose the response that is **correct** or that **best answers** the question.

A correct answer scores 1, an incorrect answer scores 0.

Marks will **not** be deducted for incorrect answers.

No marks will be given if more than one answer is completed for any question.

Question 1

Unemployment benefits are an example of:

**A.** unearned income.

**B.** transfer income.

**C.** earned income.

**D.** export income.

Question 2

An example of consumption expenditure is the:

**A.** online purchase of a concert ticket to see the Wiggles at the Melbourne Arts Centre.

**B.** expenditure on a new train stop on St Kilda Road by the state government.

**C.** payment of the Age Pension by the federal government.

**D.** purchase of a new van by a courier service.

Question 3

Which one of the following is a factor that influences both aggregate demand and aggregate supply?

**A.** exports

**B.** interest rates

**C.** consumer sentiment

**D.** rates of labour productivity (output per worker)

Question 4

The Henderson Poverty Line aims to:

**A.** measure the level of wealth inequality in Australia.

**B.** measure the level of income inequality in Australia.

**C.** provide a benchmark from which relative poverty is determined in Australia.

**D.** provide a benchmark from which absolute poverty in determined in Australia.

Question 5

Which one of the following government economic policies aims to slow the rate of economic growth in the short run?

**A.** increase in the target cash rate (interest rates) by the Reserve Bank of Australia

**B.** company tax cuts for businesses operating in Australia

**C.** increase in expenditure on public infrastructure

**D.** income tax cuts for Australian residents

Question 6

Which one of the following is **not** a trade-off of pursuing economic growth to the detriment of environmental sustainability?

**A.** increased damage to common access resources

**B.** increased risk of dangerous climate change

**C.** increased depletion of natural resources

**D.** rising levels of income inequality

Question 7

A factor that is likely to cause an increase in aggregate demand in the Australian economy is:

**A.** an increase in interest rates paid on home loans.

**B.** a 10% improvement in the level of business confidence.

**C.** an increase in labour productivity (output per worker) of the Australian labour force.

**D.** a slowdown in world economic growth triggered by a trade war between China and the USA.

Question 8

Environmental sustainability refers to:

**A.** economic development that does not pollute air quality.

**B.** utilisation of natural resources to maximise economic output.

**C.** preservation of the natural environment for future generations.

**D.** policies by the government to reduce protection of the natural environment.

Question 9

Which one of the following is **not** a government policy response to reduce the environmental effects of economic growth?

**A.** a ban on dumping commercial waste into the Yarra River

**B.** fishing licences for commercial operators in Port Phillip Bay

**C.** subsidies paid to an aluminium smelter to reduce its electricity costs

**D.** payment of grants to farmers to plant trees to offset (reduce) carbon pollution

Question 10

Consider the following Gini Coefficient data for the disposable income of a hypothetical economy.

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| **Year** | **Gini Coefficient** |
| 2010 | 0.37 |
| 2018 | 0.33 |

Based on the data above, which of the statements is **most correct**?

**A.** The level of inequality increased from 2010 to 2018, and the Lorenz Curve will have moved closer to the 45o line.

**B.** The level of inequality decreased from 2010 to 2018, and the Lorenz Curve will have moved closer to the 45o line.

**C.** The level of inequality increased from 2010 to 2018, and the Lorenz Curve will have moved further away from the 45o line.

**D.** The level of inequality decreased from 2010 to 2018, and the Lorenz Curve will have moved further away from the 45o line.

Question 11

An economic cost of attempting to achieve improved equity in income distribution could be:

**A.** increased expenditure on transfer payments by the federal government.

**B.** more incentive for individuals to improve their skill levels.

**C.** decreased interest rates for home loans.

**D.** higher levels of labour productivity.

Question 12

The government can improve equity in the distribution of income through use of all of the following policies, except:

**A.** income tax cut for those earning less than $37 000.

**B.** a 10% Increase in the Newstart Allowance (unemployment benefits).

**C.** a $2000 subsidy paid to university students to offset the cost of books and tuition fees.

**D.** removal of the exemption to the Goods and Services Tax (GST) on basic food, health and education services.

Question 13

Falling levels of labour force participation can damage the economy as a result of all of the following, except:

**A.** putting upward pressure on labour costs.

**B.** increasing the likelihood of skill shortages.

**C.** discouraging young people from joining the labour market.

**D.** decreasing income tax collections for the federal government.

Question 14

Social wage income is defined as:

**A.** gross income less direct taxes.

**B.** income spent on your social life.

**C**. wages plus rent plus dividends plus interest.

**D.** disposable income plus indirect government benefits such as public education and health.

Question 15

Which of the following factors will cause an increase in aggregate supply?

**A.** an increase in interest rates

**B.** an increase in the company tax rate

**C.** an increase in the labour force participation rate

**D.** an increase in the frequency of natural disasters

**END OF SECTION A**

Section B: Written responses

Area of Study 1: ‘Economic growth, long-term economic prosperity and environmental sustainability’

**Instructions for Section B**

Answer **all** questions in pen in the spaces provided.

Question 1 (8 marks)

**a.** Describe the impact of the following **two** factors on Australia’s aggregate demand. 4 marks

* The Westpac Melbourne Institute Consumer Sentiment Index increases by 5% from 100 to 105.

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* The federal government reduces income tax rates.

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**b.** Describe the impact of the following **two** factors on Australia’s aggregate supply. 4 marks

* Victoria and New South Wales suffer from prolonged drought conditions.

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* Labour productivity rises by 3%.

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Question 2 (9 marks)

**a.** Distinguish between real GDP and real GDP per capita. 2 marks

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**b.** Explain how the following limitations reduce the effectiveness of real GDP per capita as a measure of living standards. 4 marks

* Limitation 1: Exclusion of non-market goods and services

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* Limitation 2: Ignores the impact of depletion of natural resources used in the production process

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**c.** Analyse how an alternative to real GDP per capita as an economic indicator can better measure changes in living standards. 3 marks

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Question 3 (8 marks)

Refer to the graphs below and then answer the questions that follow.

Projected Australian population aged 65 and over, by age group, 30 June, 2016 and 2046



Source: *Older Australians at a glance*, 21 April 2017, <https://www.aihw.gov.au/reports/older-people/older-australia-at-a-glance/contents/demographics-of-older-australians/australia-s-changing-age-and-gender-profile>

PROPORTION OF POPULATION AGED 65 AND OVER



Sources: ABS cat no. 3105.0.001, 3101.0 and Treasury projections, graph published as Chart 1.6 in *2015 Intergenerational report Australia in 2015*, March 2015, page 13, <https://static.treasury.gov.au/uploads/sites/1/2017/06/2015_IGR.pdf>

**a.** Using information from the diagram above, assess the potential impact of an ageing population on: 6 marks

* The federal government’s tax receipts and outlays

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* Future rates of economic growth

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**b.** Identify and describe an example of an aggregate supply response designed to reduce the negative impacts of an ageing population on future rates of economic growth. 2 marks

 Government policy response: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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**END OF SECTION B**

Section C: Written responses

Area of Study 2: ‘Economic efficiency and equity’

**Instructions for Section C**

Answer **all** questions in pen in the spaces provided.

Question 1 (10 marks)

**a.** Distinguish between absolute poverty and relative poverty. 2 marks

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**Part b.** and **part c.** relate to the following case study.

CASE STUDY: BEN (20—UNEMPLOYED)

Ben left school halfway through Year 10 when he was 16. He could not find work and was disruptive at home, so his parents asked him to leave because he was not working or studying. He started sleeping at friends’ houses but also spends some nights on the streets ‘sleeping rough’ as he can’t always rely on friends to help him out.

Ben is now 20 and says he has matured and now wants to get a job. He says he has applied for many jobs but can’t find one and most employers don’t reply to his applications. He has no work experience or qualifications. Ben is prepared to do any kind of work so he can improve his situation.

**b.** Referring to the case study above, explain **two** possible causes of poverty for young Australians. 4 marks

Cause 1: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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Cause 2: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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**c.** Explain how poverty could influence the living standards of young Australians. 4 marks

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Question 2 (10 marks)

**a.** Define the term ‘technical efficiency’. 1 mark

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**b.** Distinguish between efficiency of resource allocation and equity in the distribution of income.

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**c.** Discuss **two** different examples of how budgetary policy could be used to influence equity in the distribution of income and also: 6 marks

* improve efficiency in resource allocation

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| * worsen efficiency in resource allocation

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**END OF SECTION C**

Section D: Written responses

Area of Study 3: ‘Global economic issues’

**Instructions for Section D**

Answer the following questions based on a **selected global economic issue** that you have investigated this year.

Answer **all** questions in pen in the spaces provided.

Question 1 (2 marks)

Describe the selected global economic issue.

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Question 2 (3 marks)

Explain **one** economic reason why the global economic issue is of importance to the Australian economy.

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Question 3 (4 marks)

Describe **two** economic factors that could influence the global economic issue.

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| Factor 2 |
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Question 4 (6 marks)

Evaluate the costs and benefits associated with action undertaken by relevant stakeholders to address the selected global issue.

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**END OF QUESTION AND ANSWER BOOK**

**Extra space for responses**

**Clearly number all responses in this space.**

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Economics Unit 2 practice exam 2018

**ANSWER SHEET FOR SECTION A**

**Student name**: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Use a **pencil** for **ALL** entries. For each question, shade the box that indicates your answer. All answers must be completed like the example below.

**1** A B C D

Marks will **not** be deducted for incorrect answers.

**NO MARK** will be given if more than **one** answer is completed for any question.

If you make a mistake, **erase** the incorrect answer—**DO NOT** cross it out.

**ONE ANSWER PER LINE**

**1.** A B C D

**2.** A B C D

**3.** A B C D

**4.** A B C D

**5.** A B C D

**6.** A B C D

**7.** A B C D

**8.**  A B C D

**9.** A B C D

**10.** A B C D

**11.**  A B C D

**12.** A B C D

**13.** A B C D

**14.**  A B C D

**15.**  A B C D

Suggested answers

Section A: Multiple-choice questions

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 1B | 2A | 3B | 4C | 5A | 6D | 7B | 8C | 9C | 10B |
| 11A | 12D | 13C | 14D | 15C |

Section B: Written responses—Area of study 1

Question 1 (8 marks)

**a. Describe the impact of the following *two* factors on Australia’s aggregate demand.**

 **4 marks**

* **The Westpac Melbourne Institute Consumer Sentiment Index increases by 5% from 100 to 105.**

The Westpac Melbourne Institute Consumer Sentiment Index measures changes in the level of consumer confidence in economic activity, that is, it measures households’ evaluations of their current and future financial situation and future economic conditions. Therefore, an increase in the measure indicates that households are more optimistic about their own finances, sense of job security, likely wage growth and buying conditions for major household items, which can translate into increased consumption and expenditure on imported goods and services. Any increase in the largest component of aggregate demand (consumption) will ultimately put upward pressure on Australia’s aggregate demand, despite some leakage to the overseas sector.

* **The federal government reduces income tax rates.**

If the federal government reduces income tax rates, income taxpayers would have higher disposable incomes. An increase in disposable incomes would encourage greater consumption of household goods and services. At the margin, there would also be an increase in private investment expenditure as some households would choose to build a new home or extend their existing one. Also, there would be some leakage to the overseas sector as households buy goods from overseas; however, the overall impact should be an increase in aggregate demand.

*Marking guide:*

***1 mark*** *for an accurate explanation of the components of aggregate demand that are affected by the factor (x two = 2 marks)*

***1 mark*** *for correctly identifying the overall impact of each factor on aggregate demand (x two = 2 marks)*

**b. Describe the impact of the following *two* factors on Australia’s aggregate supply.**

 **4 marks**

* **Victoria and New South Wales suffer from prolonged drought conditions.**

A period of prolonged drought conditions could have serious negative consequences for Australia’s aggregate supply. In particular, industries such as agriculture may suffer a significant increase in the cost of production and loss of productivity as water becomes increasingly scarce. This could lead to many affected farmers leaving the land as it is no longer profitable to produce. Additionally, the impacts could be felt throughout the economy through higher food and water prices, both of which would reduce the profitability of affected industries. From an economy-wide perspective, it would be expected that the willingness and ability of firms to supply should fall, leading to a decrease in the aggregate supply of the Australian economy.

* **Labour productivity rises by 3%.**

Labour productivity measures the output per hour worked. If this measure was to improve by 3% across the economy, effectively this means firms are able to produce more for each unit of labour. This would have the positive impact of increasing the profitability of Australian firms, which should increase the ability and willingness of Australian businessesto produce, and therefore increase Australia’s aggregate supply.

 *Marking guide:*

***1 mark*** *for an accurate explanation of how each factor can influence aggregate supply (x two = 2 marks)*

***1 mark*** *for correctly identifying the overall impact of each factor on aggregate supply (x two = 2 marks)*

Question 2 (9 marks)

**a. Distinguish between real GDP and real GDP per capita. 2 marks**

Real GDP measures the output of the economy after making an adjustment for changes in prices. On the other hand, real GDP per capita measures output after making an adjustment for changes in prices in an economy and then dividing the result by the population of the economy. A key point of difference is that real GDP measures changes in the volume of production, whereas real GDP per capita measures changes in the volume of output on a per-person basis.

*Marking guide:*

***1 mark*** *for an accurate definition of both real GDP and real GDP per capita*

***1 mark*** *for identifying a point of difference*

**b. Explain how the following limitations reduce the effectiveness of real GDP per capita as a measure of living standards. 4 marks**

* **Limitation 1: Exclusion of non-market goods and services**

Non-market goods and services include those items that are not transacted in a legal market. For example, unpaid home services such as child care, gardening and cleaning are all excluded from GDP calculations, as are charitable services and black market goods and services. The existence of non-market goods and services means that GDP can significantly underestimate the volume of goods and services produced in the economy. If all these goods and services were counted, then GDP per capita would be higher, and so would material living standards.

* **Limitation 2: Ignores the impact of depletion of natural resources used in the production process**

GDP per capita simply measures the value of output per person. The measure does not take into consideration any depletion of non-renewable resources such as fossil fuels, air and water quality used in the production process. For example, if production has come at the cost of significant natural resource depletion, for example via the removal of mineral resources, it is the living standards of future generations that will suffer as the environment will no longer have the ability to sustain economic growth at the same level as was possible in the past.

*Marking guide:*

***1 mark*** *for an explanation of each limitation (x two = 2 marks)*

***1 mark*** *for linking the limitation to living standards (x two = 2 marks)*

**c. Analyse how an alternative to real GDP per capita as an economic indicator can better measure changes in living standards. 3 marks**

 ***Note:*** *This is one of a number of possible answers to this question.*

The Genuine Progress Indicator (GPI) is an index that seeks to measure overall living standards for a particular economy. The GPI seeks to overcome some of the weaknesses of GDP. It starts with the GDP measure, and essentially makes adjustments to the level of a nation’s GDP for negative and positive influences on society caused by both consumption and production. For example, the GPI reduces GDP for the negative impacts of economic production such as environmental damage, which could reduce the living standards of those citizens of the economy.

Additionally, the GPI makes positive adjustments for production (such as volunteer work) that has a positive effect on society but would not otherwise be recorded by GDP. The aim is to provide an indicator that more accurately reflects changes in living standards rather than simply changes in the volume of goods and services produced.

*Marking guide:*

***1 mark*** *for an outline of an appropriate alternative indicator to real GDP per capita*

***2 marks*** *for a logical high-level discussion of how the indicator better measures living standards*

Question 3 (8 marks)

**Refer to the graphs below and then answer the questions that follow.**

1. **Using information from the diagram above, assess the potential impact of an ageing population on: 6 marks**
* **The federal government’s tax receipts and outlays**

The ageing population refers to the prediction that over the next 40 years Australia’s population is expected to become progressively older. The ageing of the population will place additional pressures on the federal government’s budget balance, which is calculated as taxation receipts minus government outlays. The diagrams predict that there will be a significant increase in the number of individuals over the age of 65. This increase will create budgetary pressures in terms of increasing demand for medical and aged care services as well as transfer payments such as the Age Pension. In addition, it is predicted that there will also be a significant increase in the proportion of the population aged 65 from around 15% in 2014–15 to around 23% in 2054–55, which will cause a fall in the ratio of working-age individuals to the population. This is likely to mean that tax receipts will not be sufficient to keep pace with increasing health spending and related outlays. This could lead to difficult decisions such as increasing taxes, reducing welfare payments and aged care services, and/ or future higher budget deficits.

* **Future rates of economic growth**

Without an increase in the labour supply and worker productivity, it is likely that future economic growth rates will fall. As Australians age, on average, a smaller proportion of the population will be of working age and therefore the size of the labour supply is likely to fall. Australian firms will suffer labour shortages and therefore rising real wage costs, and firms will likely become less internationally competitive, suffer falling market share, become less profitable and therefore less willing to supply, thus reducing aggregate supply. Additionally, government expenditure will face increased demand for aged care services and the Age Pension, thus forcing governments to increase taxes and/or debt (resulting in more borrowing), which both ultimately have negative consequences for aggregate demand and future rates of economic growth.

*Marking guide:*

***1 mark*** *for an accurate reference to the diagrams*

***1 mark*** *for an accurate definition of ‘ageing population’*

***2 marks*** *for a detailed explanation of the link between an ageing population and proportionately smaller income tax receipts and greater outlays*

***2 marks*** *for a detailed explanation linking a lower labour force participation rate and higher labour costs, lower profitability and the downward pressure on future rates of economic growth*

**b. Identify and describe an example of an aggregate supply response designed to reduce the negative impacts of an ageing population on future rates of economic growth. 2 marks**

* **Government policy response: Infrastructure**

The federal government can continue to invest in transport infrastructure with the aim of reducing transport bottlenecks and therefore reducing business costs and improving the efficiency of Australian firms. This can have the effect of improving the competitiveness of Australian industries, which in turn encourages expansion and improvement in the nation’s aggregate supply as firms are more willing to produce. Additional production will therefore stimulate employment, wages and economic growth, which will have a positive impact on future rates of economic growth.

*Marking guide:*

***1 mark*** *for identifying a relevant aggregate supply policy response*

***1 mark*** *for describing the aggregate supply policy response and its effect on reducing the impact of an ageing population on future economic growth rates*

Section C: Written responses

Area of Study 2: ‘Economic efficiency and equity’

**Instructions for Section C**

Answer **all** questions in pen in the spaces provided.

Question 1 (10 marks)

**a.** **Distinguish between absolute poverty and relative poverty. 2 marks**

Absolute poverty refers to the situation in which an individual has insufficient income to afford the necessities of life, such as water, shelter and food. In contrast, an individual is said to be living in relative poverty when they have insufficient income to afford a dignified living standard according to societal norms. A point of difference is that absolute poverty is a situation where the individual’s life is in jeopardy, whereas an individual living in relative poverty may be able to survive but have difficulty participating in society.

*Marking guide:*

***1 mark*** *for an accurate definition of both absolute and relative poverty*

***1 mark*** *for identifying a point of difference*

**b.** **Referring to the case study above, explain *two* possible causes of poverty for young Australians. 4 marks**

**Cause 1**: **Lack of skills and work experience**

Young Australians can find it difficult to enter the labour market due to insufficient training and experience in the workforce. Without the requisite skills and experience to participate in the labour market, young people can quickly become long-term unemployed and only have access to government welfare, such as the Newstart Allowance as a source of income. This relatively low income will make it very difficult for young Australians such as Ben to afford necessities considered normal for ‘average’ Australians and therefore contribute to young Australians living in relative poverty.

**Cause 2: Lack of affordable housing**

Young Australians can find it difficult to gain access to affordable accommodation. This is a significant problem, particularly in Australia’s capital cities where it is very difficult to find affordable rental accommodation while relying on government transfer payments, such as the Newstart Allowance plus Rent Assistance, as a sole source of income. This lack of affordable rental accommodation can contribute to young Australians such as Ben having to ‘sleep rough’ on the streets, which highlights how a lack of affordable housing and the subsequent high rates of homelessness contribute to young Australians living in relative poverty.

 *Marking guide:*

***1 mark*** *for accurately identifying each cause of poverty (x two = 2 marks)*

***1 mark*** *for a logical explanation of how each cause contributes to poverty (x two = 2 marks)*

**c.** **Explain how poverty could influence the living standards of young Australians. 4 marks**

 Young Australians living in poverty, like Ben, are likely to be unemployed and struggle to find permanent accommodation. This could quickly lead to feelings of isolation and helplessness as young Australians in this situation are unable to meaningfully participate in many aspects of Australian society such as paid work. Not being able to find paid work can lead to physical and mental health issues such as depression, which could significantly negatively impact on non-material living standards of young Australians living in poverty.

 Living in impoverished conditions is likely to quickly lead to poor health outcomes for young Australians as the ability to access medical care will be limited by income. This can further compound the ability of young people to engage in education, thus resulting in low education and skill levels and an increased likelihood of unemployment in later life. This can have serious negative consequences for material living standards as future income-earning potential will be limited.

 *Marking guide:*

***2 marks*** *for a detailed explanation linking poverty to worsening material living standards*

***2 marks*** *for a detailed explanation linking poverty to worsening non-material living standards*

Question 2 (10 marks)

**a. Define the term ‘technical efficiency’. 1 mark**

Technical efficiency measures the effectiveness with which a given set of inputs is used to produce an output. This type of efficiency is said to have been achieved when it is not possible to increase output without increasing inputs.

*Marking guide:*

***1 mark*** *for an accurate definition of technical efficiency*

**b. Distinguish between efficiency of resource allocation and equity in the distribution of income. 3 marks**

The achievement of equity in the distribution of income refers to the situation in which Australians have sufficient income to purchase the goods and services that enable them to have a dignified living standard. Additionally, no Australian should live in absolute poverty and obscene inequalities in income distribution are avoided. Alternatively, achieving efficiency in resource allocation focuses on ensuring that the economy directs scarce resources to areas that best satisfy society’s needs and wants. At this point living standards are maximised and it is not possible to improve living standards by reallocating resources as both allocative and technical efficiency have been achieved.A point of difference is that equity in the distribution of income focuses on income disparity between individuals and households in an economy, whereas efficiency of resource allocation focuses on how resources are allocated and utilised in an economy.

 *Marking guide:*

***2 marks*** *for an accurate definition of both efficiency in resource allocation and equity in the distribution of income*

***1 mark*** *for identifying a point of difference*

**c. Discuss *two* different examples of how budgetary policy could be used to influence equity in the distribution of income and also: 6 marks**

* **improve efficiency in resource allocation**

The government has argued that reducing income tax rates for low- to middle-income earners as part of Australia’s progressive income tax system could result in a reduction in income inequality and therefore assist in achieving the goal of equity in the distribution of income. At the same time, this budgetary policy decision could increase the incentive for Australians to become more entrepreneurial and perhaps establish a new business or invest in their education and training to improve their skills base and hence become more productive. Both examples could assist in improving the technical efficiency of the economy and therefore be compatible with the achievement of a more efficient allocation of resources.

* **worsen efficiency in resource allocation**

The government could pursue the goal of equity in the distribution of income by increasing the amount paid to unemployed individuals through the welfare system. This could result in an increase in the incomes of some of Australia’s lowest income earners and therefore reduce income inequality in the Australian economy. There is the risk, however, that an increase in unemployment benefits might act as a disincentive for individuals to increase their level of training in an effort to join the labour force and, as a result, put upward pressure on labour costs and make Australian firms less technically efficient.

*Marking guide:*

***1 mark*** *for identifying each policy measure that could be used to influence the achievement of equity in income distribution (x two = 2 marks)*

***2 marks*** *for a detailed and logical explanation of how the first budgetary measure could be used to influence equity in the distribution of income and efficiency in resource allocation*

***2 marks*** *for a detailed and logical explanation of how the second budgetary measure could be used to influence equity in the distribution of income while also reducing efficiency in resource allocation*

Section D: Written responses—area of study 3

***Note:*** *The global economic issue on which the answers to the following questions are based is ‘The challenges faced by developing nations in improving living standards and alleviating poverty’. The other global economic issues that students may investigate can be found on page 16 of the* VCE Economics Study Design *(2017–2021).*

Question 1 (2 marks)

**Describe the selected global economic issue.**

Developing nations are often referred to as those countries with relatively low economic development that are in the process of improving their level of economic development with the aim of improving living standards and alleviating poverty for their citizens. This process of economic development ultimately involves the improvement of income and wealth for a country’s citizens. This is usually achieved through development of economic infrastructure such as transport, health and education systems as well as improvements in civil liberties. However, developing nations often face considerable barriers to the achievement of improved living standards, including limited productive resources, inequities in global trade, a history of colonialism, government corruption, high levels of public debt, and a lack of roles for women in the economy, to name a few.

*Marking guide:*

***2 marks*** *for accurately describing the global economic issue*

Question 2 (3 marks)

**Explain *one* economic reason why the global economic issue is of importance to the Australian economy.**

***Note:*** *The following answer is one of a number of possible answers to this question.*

Australia is a relatively wealthy, resource-rich nation with a relatively small population that relies on trade as an important contributor to its prosperity. As such, the Australian federal government has stated that one of its aims is to ensure Australia’s overseas aid program works in ‘partnership with governments to better integrate our economies through transformative infrastructure, open access to Australian markets and facilitation of trade’. In the long-term this could be of benefit to both the developing economy and the Australian economy, as potentially the developing country could become a significant trading partner. Such an outcome could be of mutual benefit to both nations.

*Marking guide:*

***3 marks*** *for a detailed explanation of why the global economic issue is of importance to Australia*

Question 3 (4 marks)

**Describe *two* economic factors that could influence the global economic issue.**

***Note:*** *The following answer is one of a number of possible answers to this question.*

**Factor 1**

Protectionist trade policies can make it difficult for developing nations to earn export income and therefore improve material living standards. This is because many developing nations rely heavily on agricultural commodity exports as their major source of export income. Many governments of rich, developed nations protect their domestic agricultural industries by providing generous subsidies that effectively reduce the cost of production. This puts downward pressure on world agricultural commodity prices, which makes it difficult for agricultural producers of developing economies to compete against cheaper imports from developed economies. Ultimately, such protectionist policies result in a loss of income and employment for the developing nation, which can further exacerbate existing levels of poverty.

**Factor 2**

An economic factor contributing to poverty in developing nations could be high levels of public debt. Borrowing and debt can be a vital source of funds for developing nations to finance the production of basic infrastructure such as transport links, sewerage systems and telecommunications networks that allow civil society and businesses to flourish. However, if the developing nation has taken on too much public debt and the funds have been used inappropriately, this means that the government might not have the capacity to service the loans in the future. This can create significant opportunity costs for the country. For example, highly indebted developing nations like Chad and Niger may have to divert taxation revenue away from the funding of essential services such as health and education to loan repayments, thereby making it difficult for these poor countries to climb out of poverty.

*Marking guide:*

***2 marks*** *for a detailed description of how each economic factor could influence the global economic issue (x two = 4 marks)*

Question 4 (6 marks)

**Evaluate the costs and benefits associated with action undertaken by relevant stakeholders to address the selected global issue.**

***Note:*** *The following answer is one of a number of possible answers to this question.*

Many developed nations, including Australia, seek to provide assistance to developing nations in various forms of debt forgiveness with the aim of tackling the problem of poverty in the developing nation. Debt forgiveness involves the cancellation of debts owned by developing nations to their overseas creditors, including the World Bank. There are several costs and benefits of this strategy, which are discussed below.

A key benefit of debt forgiveness is that it allows indebted nations to make a ‘fresh start’ and allows the indebted nation to redirect economic resources that were channelled to the repayment of interest and principal to the provision of essential services and infrastructure. Effectively the opportunity cost of the loan repayments will be eliminated, allowing the government to focus on improving living standards.

Another advantage of the eradication or reduction of debt is that it could help to stabilise a new government that is aiming to improve the living standards of its people. Many developing nations have suffered from corrupt and incompetent governments that squandered the amounts borrowed for little or no gain for the population. This meant it was practically impossible for any subsequent government to earn sufficient tax revenue to meet the debt repayments and still provide the services needed to improve living standards. Consequently, an elimination or restructuring of existing debt could provide hope, and improve the legitimacy of the existing government.

A cost associated with the elimination of debt is the risk of ‘moral hazard’. For example, should the debt be eliminated, what is to stop the developing nation from making the same mistakes again? Additionally, as a representative of the developed nation lenders, the World Bank is well aware of this risk and therefore is likely to impose strict requirements on the developing nations taking up the option of debt forgiveness. This may reduce the overall benefit of debt forgiveness for the developing nation.

Overall, there are a number of costs and benefits of debt forgiveness; however, if used effectively this strategy can help developing countries escape the debt and poverty trap, and improve their level of economic development and the living standards of their populations.

*Marking guide:*

***1 mark*** *for outlining the action taken by stakeholders to address the selected global issue*

***2 marks*** *for a detailed explanation of each benefit (minimum of one benefit)*

***2 marks*** *for a detailed explanation of each cost (minimum of one cost)*

***1 mark*** *for an overall evaluation of the cost(s) and benefit(s) of the action*

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