

# Economics

# SAC 3.1 UNIT 3 OUTCOME 1

**2023**

**You will have 60 minutes to complete this task plus 5 minutes reading time**

**Teacher: Mr. Daniel Charles/SFB**

The total SAC contributes to 35/100 of SAC marks allocated for Unit 3.

**Allowed materials for this task include:**

* Pens, pencils, rulers, erasers, highlighters

Name \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

***Note:*** *The grade or score for this task is only part of the internal assessment for this Unit. Your* ***total*** *School-assessed Coursework score may change as a result of statistical moderation by VCAA.*

**Grade/Score: \_\_\_\_\_\_ Satisfactory Completion? S/N: \_\_\_\_\_\_**

**(Provisional)**

**Section A – Multiple Choice (5 marks)**

**Question 1**

The opportunity cost of building a new road network could be

1. increased noise pollution.
2. a reduction in public transport usage.
3. the inability to adequately fund education.
4. the road levy charged to all users of the road.

**Question 2**

Which one of the following is not likely to contribute to a rise in house prices?

1. lowering of interest rates
2. easing restrictions on lending
3. government spending on new public housing
4. removal of border restrictions, allowing more immigration

**Question 3**

Which one of the following goods is not likely to be considered a public good?

1. a fireworks display
2. street lighting
3. healthcare services
4. free-to-air TV broadcasts

**Question 4**

Which one of the following products would have a vertical supply curve?

1. apples
2. haircuts
3. streaming services
4. paintings by an artist who is now dead

**Question 5**

The degree of price elasticity of demand is important to producers because it reveals how

1. responsive quantity demanded is to a change in price.
2. much of the product will be supplied at different prices.
3. responsive demand for a product is to advertising or promotional campaigns.
4. responsive quantity demanded is to a change in the level of consumer income.

**Section B – Short answer questions (35 marks)**

**Question 1** **(11 marks)**

a. Using a production possibility frontier model (PPF) outline the meaning and significance of one type of economic efficiency.

3 marks



Productive or technical efficiency is when firms are producing at the lowest cost possible, and it is not possible to increase output without increasing inputs. It is significant because when a firms in an economy are being productively efficient it means they are utilising all of their scarce land, labour, and capital resources and output will be maximised. In relation to the production possibility frontier above, all points along the PPF would be considered productively efficient because at any output point along the PPF, all resources are being fully employed.

b. Explain the theory of the law of supply

2 marks

The law of supply states that there is a positive relationship between price and quantity supplied, *meaning if there is an increase in the price of a good or service, quantity supplied will increase, while if there is a decrease in the price of a good, then quantity supplied will decrease, ceteris paribus.*

This can be explained by the profit motives of producers. As the price increases, ceteris paribus, it will increase the profitability firms as they get more revenue per unit sold. This will increase their ability to produce more goods and services in the market. The increase in total revenue also will incentivise firms to supply more goods and services in response to the increase in price.

c. Distinguish between a movement along the demand curve and a shift of the demand curve

3 marks

A movement along the demand curve represents a change in quantity demanded for a good due to a change in price, while a shift of the demand curve represents a change in demand for a good or service at every price. The key difference between them is that movements are only caused by a change in price of the good, while shifts are caused by non-price factors such as disposable income, taste and preferences, and the price of substitute goods.

d. Distinguish between a substitute and a complement in demand

3 marks

A substitute is a good that can be consumed in place of another as it serves a similar purpose, for example coke and pepsi, while complementary goods are two goods that are usually consumed together, such as printers and print ink. One key difference between them is that if there is an increase in price of a substitute, there will be an increase in demand for the other good, while if there is an increase in price for a complementary good, it will lead to a decrease in demand for the other good.

**Question 2 (8 marks)**

Explain the impact that a flood would have on the equilibrium price and quantity traded in the market for wool.

4 marks

If there was a severe weather event like a flood, it could be assumed that this would lead to a decrease in the supply of wool at every price, as sheep or stored wool might be damaged or destroyed from the floods. At the original equilibrium price, this would lead to a shortage of wool in the market as quantity demanded is now greater than quantity supplied. Due to the shortage, consumers would ‘bid up’ the price over time, leading to a new higher equilibrium price. As the price of wool increases, this would lead to an expansion in the supply of wool, and a contraction in the demand of wool, until quantity demanded of wool equalled quantity supplied, creating a new lower equilibrium quantity in the market.

b. Explain factors affecting the price elasticity of supply of a good or service.

4 marks

Price elasticity of supply measures the responsiveness of quantity supplied to a change in price\*. One factor that impacts the price elasticity of supply for a good is production period. If a good, such as an avocado, has a long production period, it means that firms are unable to respond quickly to price changes, making supply inelastic. On the other hand, a short production period would make a firm more able to respond to price changes quickly.

Another factor affecting the price elasticity of supply for a good would be the spare capacity of firms. If firms have unused and underutilised land, labour and capital resources, it means that they have a greater ability to respond to changes in price. On the other hand, if firms have little spare capacity it would make them less able to supply goods in the event of a price increase, making supply inelastic.

\*Definition not essential for full marks

**Question 3 (16 marks)**

a. Evaluate the role of free and competitive markets in promoting an efficient allocation of resources

 6 marks

Free and competitive markets play a pivotal role in the allocation of Australia’s scarce land, labour and capital resources. A market with many sellers that is free from government intervention should usually lead to allocative efficiency, where resources are allocated to the maximum benefit of society. Free and competitive markets allocate resources via what is called the ‘market mechanism’, where changes in demand and supply will lead to an increase or decrease in the relative price of goods and services. These changes to relative prices will then send signals to producers about the relative profitability of particular goods and services, leading to a reallocation of scarce land, labour and capital resources towards markets that are most profitable, usually with no government intervention is needed to achieve this. It is in this way it can be seen that free and competitive markets allocate resources to the optimal satisfaction of consumers, achieving allocative efficiency and consumer sovereignty.

That said, free and competitive markets do not always lead to allocative efficiency, and the government might still have an important role in achieving allocative efficiency in the presence of market failure, which is where a free market leads to a suboptimal allocation of scarce resources. These include externalities, the lack of public goods, common access resources and the presence of asymmetric information. For example, in a free market there would be negative externalities associated with the production of coal-powered energy. The pollution caused from producing energy that is powered by burning coal leads to negative social costs on society in the form of damage to the environment. In a free market, profit maximising producers would not have to internalise these social costs and this leads to an over-production and over-allocation of our economy’s scarce land, labour and capital resources to the coal-powered energy market. This shows how the free market has failed to achieve allocative efficiency in this case, and how government intervention in the form of taxation or regulations might lead to a more efficient allocation of resources over time.

Overall, while free and competitive market will often play a large role in achieving an efficient allocation of resources, this is not always the case, especially the presence of market failure, where the government might also have a role in the efficient allocation of resources.

b. Outline the role and effect of indirect taxation in the market to address one type of market failure.

4 marks

Indirect taxation can be used to address the market failure of negative externalities. Negative externalities are when the production or consumption of a good has negative spillover effects on a third party. In the example of the tobacco market, indirect taxes (taxes levied on the spending to buy goods and services) will increase the costs of production for firms, forcing them to ‘internalise’ the negative social costs of tobacco consumption, such as second-hand smoke lung disease. This will decrease tobacco producers’ ability to supply at every price, ultimately leading to a new higher equilibrium price and lower equilibrium quantity in the market for tobacco.

The higher price and lower profitability of firms ensures scarce resources are allocated away from the production of tobacco, fixing the overallocation of resources towards this market and leading to greater allocative efficiency.

c. Using a diagram, explain how advertising can be used to correct the market failure of positive externalities.

6 marks

2 marks for diagram

4 marks for the explanation

* advertising will shift demand curve right, lead to more resources being allocated towards the market for something like healthcare with has positive externalities of consumption

*Sorry for no model answer I’m tired and need to go home! 😊*