

**2013 May TZ1**

Part B

3.

**(a) Explain why the market system may not result in an equitable distribution of income**

- Equity: fairness in equal distribution of income which requires some value judgement
- People have different ownership of resources
  - Land, labour, capital and entrepreneurship
  - E.g: some people inherit from their parents a block of land that can be rent or can be used to farm, they have an advantage in making profits from the assets that they own.
    - Thus rich people may become richer
    - Poor people have to spend most of their income in purchasing necessities and thus they would have little disposable income left
    - In Melbourne, the mean per week
  - It is harder for low-income earners to accumulate assets as they tend to spend most or all of their disposable income to maintain daily survival while the high income earners redirect their savings in income earning assets.
- Price of various factors of production differs
  - Especially the wages of various types of jobs are reflective of the labour demand and labour supply.
    - Usually low income earners' jobs would be in surplus in the economy and thus it usually drives down their wages and they have to settle for minimum wage which is 18 per hour in Australia.
      - For instance, In America, people on minimum wage may be considered as the working poor as their income of 7.5 dollars per hour is not sufficient for them to uphold a dignified standard of living ('relative poverty' which compares to others in the society and the high income earners)
      - This is compared to high skilled people with specialties that there are usually a shortage of them in the economy. The business has to increase the wage in order to attract suitable skilled labour, resulting in the bidding up of wages due to scarcity
      - The gap between low and high income earners widens, result in income inequality
- The most significant cause of income inequality is unemployment. Unemployment benefit is well below the poverty line, in Australia, the unemployment benefit is around \$350 whereas the poverty line is around \$520. It is harder for the low income earners to enjoy a 'dignified standard of living' as their income may not be sufficient to fulfil their needs and wants. Overtime, they will further build wealth. Thus overtime, the gap between high income earners and low income earners widens.

Equity: A term that needs some 'value judgement' because the degree to which a society looks to protect their citizens from poverty and large gaps in final disposable income will be reflective of the prevailing values.

(b) Evaluate government policies to promote equity in terms of their effects on efficiency in the allocation of resources

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4.

**(a) Explain how labour market reforms may be used to promote economic growth**

Economic growth refers to the increase in total volume of goods and services produced in a market measured by GDP or GNI over a period of time.. Aggregate supply policies refers to any government initiative that is designed to reduce the cost of production or improve supply conditions for businesses and labour market reform aims to reduce the labour market rigidities and promote competition.

- Centralised and decentralised wage system
  - Centralised system is where the authority sets minimum wages and conditions for a range of professions and decentralised system is when negotiation happens between employers and employees.
    - Removal or reduction in unfair dismissal legislation
  - This is a system where labour supply and demand is more reflective in the market, resulting in less surplus of labour forces. High skilled workers receive a high income which encourages more people to fill in the labour shortage areas and low skilled workers are in surplus and the market naturally drives down the price due to a surplus, resulting in more firms hiring workers as they are cheaper, less people in unemployed position
  - E.g: Australia move from a centralised to a decentralised wage system in the 1990s. It effectively reduces unemployment rate from 8.5% to 5%, which means more people are receiving jobs and they may spend in the economy to purchase goods and services that may increase and promote the economic growth
  - In a decentralised wage system , workers need to show that they ‘deserve’ a pay increase→ ‘Performance based enterprise bargaining agreements’
    - Thus giving workers incentives to find ways to boost productivity, creating more products per unit of time in order to gain extra reward or income.
  - Reduce the waste associated with having a high natural rate of unemployment. Lowers the cost of production, which shifts AS curve to the right, so the government can collect more tax, then reinvested the money and further expand AS.
- Reduce union power
  - Unions try to increase and bargain a higher wage→ power weakens, wages more flexible to demand and supply that respond to society's needs and wants, allocating resources more effectively
  - E.g:NSW rail Union has been banned from striking, preventing supply disruptions
- Reduce in real value of minimum wage.
  - Firms are encouraged to hire more as it is cheaper to hire people, decrease unemployment rate
  - Greater profits for firms→ investment in research and development → increase productivity→ economic growth

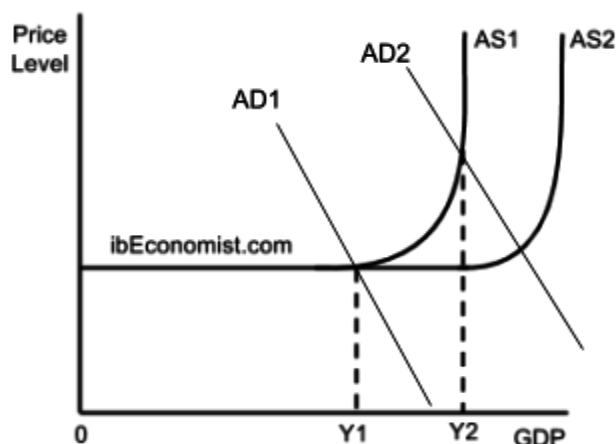
(b) “Market-oriented supply-side policies will always be more effective in promoting economic growth than demand-side policies” To what extent do you agree with this statement?

Market-oriented supply-side policies assume government intervention is ineffective, market itself will automatically eliminate inflationary and recessionary gaps, these tend to encourage competition to increase productivity. Demand-side policies are those that design to alter the composition of AD in the economy by manipulating AD to achieve economic growth.

Market based policies such as privatisation can promote economic growth by increasing the competition and boost AS as government sell a business to private sector. For example, in 1980s, the privatisation of British Telecom reduces prices by 40%. This was combined with deregulation of markets that permitted more firms to enter and compete against rivals. By selling the previously state-owned enterprises to the private sector, the firms has a discipline imposed on them to use lowest cost methods of production as they have profit incentives and must compete with new entrants, and thus will actively evaluate cost structures, and seek productivity improvements to remove areas of waste and maintain competitiveness, lowering price and increasing demand.

However, privitisation in certain areas of production give companies power to increase prices which has a negative impact on economic growth.

- Electricity increases by almost three times CPI increases in past few years
- They may not have the incentive to be more productive as they know that it is a necessity that all people need to use
- PED is low, % decrease in quantity demanded less than % increase in prices
- Technical efficiency cannot be achieved
- Opportunity cost, in spending more paying electricity bills, people cannot purchase goods and services that satisfy them, thus allocative efficiency is not being achieved.



Fiscal policy is the government manipulation of taxation and government spending in the budget. Investment in Infrastructure (G2) (physical capital provided by the government to facilitate the production process) can potentially boost economic output and adds to productive capacity of the economy, increasing productivity. As fig 1 shown, in the short run, more workers are going to be employed to work in the road project. Most of these workers are low income workers who have a high MPC (marginal propensity to consume) meaning that they inject most of their income back into the economy as “c” which is a component of AD so AD shift from AD1 to AD2, output increases from

Y1 to Y2. In the long run, spending on road networks may reduce delivery times for drivers so more deliveries can be made per hour, thus causing an increase in productivity and may shift AS1 to AS2, allowing more products to be produced per unit of time. There is also an expansion along AD2, meaning

that the international competitiveness of firms may increase due to less time spent in traffic less petrol costs, helping to reduce the costs of production. If households spend less on fuel they will also have more discretionary income for other goods and services with further promote economic growth.

However, fiscal policy may not necessarily promote economic growth as government may spend in the wrong infrastructure projects, thus wasting valuable resources. For example, Japan spends 2 trillion in infrastructure that are unused and ended up being white elephants. This not only doesn't add to the capacity of the nation but presents an opportunity cost that the government are unable to spend in other areas such as education and healthcare that may promote increase in economic growth through more people being employed and

Monetary policy is the demand management policy instrument utilised by the Central Bank of a country to alter the cost, availability and demand for credit. To promote economic growth, the central bank may use expansionary monetary policy which try to boost "c" and "I" as the two components of AD. With the decrease in interest rate, the opportunity cost of saving increases, thus people may spend more on goods and services. And firms may have the incentive to borrow more from the bank to engage in investment in human capital of physical capital that is going to boost the AD and AS in the long run.

However, this may not work due to cultural and demographic situation. For example, Japan's interest rate is zero, but this still does not encourage spending as the household saving rate is 27.0 %, people tend to save more due to their culture, which is relatively high compared to Australia, which has a high household indebtedness. In addition, 20% of Japanese population are elders over the age of 70, they tend to have their own saving goals which the decrease in interest rate would spur more saving rather than spending to increase real GDP.

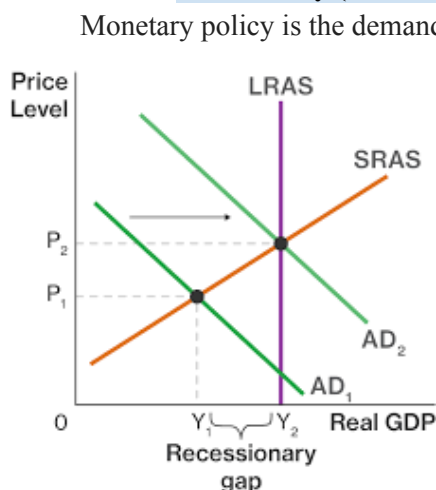
In conclusion...

**2013 May TZ2**

Section B

3.

**(a) Using a diagram, describe how expansionary monetary policy might be used to close a deflationary (recessionary) gap.**



Monetary policy is the demand management policy instrument utilised by the Central Bank of a country to alter the cost, availability and demand for credit. To promote economic growth, the central bank may use expansionary monetary policy which aims to increase the demand of consumers to purchase goods and services and private firms to invest. This is done through central bank buying bonds (issued by government, promising repayment of principal and interest), which causes money to flow from the central bank to commercial banks, increasing injections and reducing leakages out of the economy. This effectively increases the money supply, placing downward pressure on the interest rate.

This lower interest rate would decrease the rate of return on savings, thus reducing the opportunity cost of spending, people are more likely to inject their disposable income and buy goods and services. For firms, decreased interest rate decreases the opportunity cost of borrowing, which incentivises greater borrowing and spending on investment in infrastructure or vocational training. Thus, considering these, AD1 is likely to shift to AD2, the output increases from Y1 to Y2, eliminating the recessionary gap.

**(b) Discuss why, in contrast to the monetarist/new classical model, an economy can remain stuck in a deflationary (recessionary) gap according to the Keynesian model.**

Market structure is the way particular markets are organised. On the market structure spectrum, the most extreme types of market structures are perfect competition and monopoly. Perfect competition is the benchmark for comparing the degree of competition in an industry. Monopoly is the exclusive possession or control of the supply of or trade in a commodity or service. It is often assumed that price will always be lower and output will always be higher in perfect competition compared to monopoly. There are very few pure monopoly and perfect competition markets, these structures are studied to give insight into how market power affects resource allocation and living standards.

Perfect competition has few unique characteristics, the firms in this market structure are always price takers as there is a large number of independent sellers and buyers who are unable to influence the price and quantity sold. The products are homogeneous, and buyers are aware of the price and quality of all products available. There are low barriers to entry which increase the degree of competitiveness. And the resources are mobile, meaning firms are able to reallocate resources quickly to new products and labour is able to be re-employed in different industries. The demand curve is downward sloping due to the income effect where increase in price results in increase people drop out market.

Monopoly firm on the other hand, are price makers. There will be only one single seller in the market as the firm will hold a very large market share, there will be no close substitutes, consumers will also tend to have brand loyalty which means the PED is low and they will not consider substitutes. There are usually high barriers to entry, which are characteristics of the market that make it difficult for new firms to enter the market, especially when there are profit making opportunities. As a result of these conditions, monopolist have some power to set the price of goods and this contrasts with the firms operating in a perfectly competitive market who must accept the market determined price.

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In other

Natural monopoly

Economy of scale

Monetary policy have short implementation lag, which means changes can be made very quickly and it is relatively simple to alter interest rates. In Australia, the congress meet on the first Tuesday of every month to adjust the interest rate.

However, monetary policy works better to reduce AD than to increase it. It is less effective on economic downturn as people may not feel confident to spend. For example, during the 2008 GFC...Also high level

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of indebtedness will result in ineffective of monetary policy. Like fiscal policy, monetary policy also have recognition and impact lag because they rely upon information which is often delayed and it takes around 12 to 18 months to see its effect.

Fiscal policy can have political influences because the budget is prepared by the federal government which is heavily influenced by political ideology.

### 4. Same as 2013 TZ1

#### 2013 Nov TZ0

Section B:

3.

(a) Explain how changes in the size of the circular flow depend on the relative size of injections and leakages.

(b) Evaluate the use of national income statistics for making comparisons of the standard of living over time.

4.

(a) Explain why measuring the rate of inflation using a consumer price index (CPI) may not be accurate.

(b) Evaluate two government policies to reduce inflation.

#### 2014 May TZ1

Section B

3.

(a) Using two AD/AS diagrams, explain cost-push and demand-pull inflation.

(b) "The rate of inflation can be most effectively reduced through the use of monetary policy." To what extent do you agree with this statement?

4.

(a) Explain two factors which might cause economic growth.

(b) Evaluate the view that the benefits of economic growth will always outweigh the costs

Advantages:

- Higher level of living standards
  - Material and non material living standards
- Unemployment decreases
- Decreased inflationary pressures
- Reduced income inequality

Disadvantages:

- Replacement of humans with capitals
  - Foxconn replace 60,000 workers with robots
  - Jobless growth

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Unsustainable for environment:

- Depleted resources

### 2014 May TZ2

Section B

3.

- (a) Explain how the aggregate demand curve can be shifted by a reduction in interest rates.
- Increase in consumption as opportunity cost of saving increases
  - Firms spend more in investment as now cost of borrowing decreases

(b) Evaluate the effectiveness of monetary policy to increase aggregate demand during a recession.

### 4. Same as TZ1

### 2014 November

Section B

3.

- (a) Distinguish between structural and demand-deficient unemployment
- (b) Discuss the view that the problem of unemployment can be reduced through the use of supply-side policies

4.

- (a) Using an appropriate diagram, explain how a recession might lead to more poverty
- (b) Evaluate the view that attempts to achieve greater equity in the distribution of income will reduce economic efficiency

### 2015 May TZ1

Section B

3.

- (a) Explain what is meant by the natural rate of unemployment.
- (b) Discuss the view that there is no trade-off between inflation and unemployment.

4.

- (a) Explain how business spending on research and development and government expenditure on infrastructure might shift the long-run aggregate supply curve.
- (b) Evaluate the effectiveness of interventionist supply-side policies to achieve economic growth

### 2015 May TZ2

Section B

3.

- (a) Using the concept of the Keynesian multiplier, explain the possible impact of a rise in government spending on economic growth.
- (b) To what extent might unemployment represent an economic and social problem?

**4. Same as time zone 1**

**2015 November TZ0**

Section B

3.

- (a) Explain how fiscal policy can be used to achieve long-term economic growth (increases in potential output)

**Refer to 2018 May TZ1**

- (b) Discuss the view that economic growth always leads to a more equal distribution of income and reduction in unemployment.

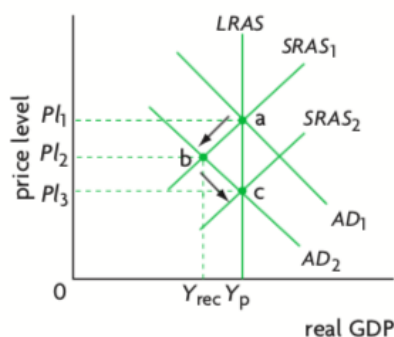
4.

- (a) **Explain why, using the new classical model, the economy will always return to the full employment level of output following a recession**

Recession is defined as two consecutive negative economic growth. The New classical model favours the market to operate itself, focus on price mechanism in markets without much government intervention and the economy in the long run will always return to the full employment. Full employment refers to the lowest rate of unemployment that the government can achieve without causing unnecessary inflationary pressures.

Initially the economy is operating at  $Y_p$ , the potential output in the economy. Due to the trade war between China and USA, China may be in a recessionary gap this potentially means that the demand for Australian exports decreases, shifts  $AD_1$  to  $AD_2$ , willingness and ability to purchase decreases. In the short run, it is assumed that wages and other factors of production is sticky and fixed due to contracts, union power, government legislations and people's unwillingness to receive wage cuts thus the market

(a) Creating and eliminating a deflationary gap



would operate at  $Y_{rec}$ , output below the potential output, creating a temporary recessionary gap and price levels decrease from  $P_1$  to  $P_2$ , reaching equilibrium b. Monetarists believe that in the long run, markets are left to operate itself to go back to full employment level of output as it is assumed that all prices are flexible and will change to match the conditions in the market. Wages are flexible as contracts finishes, the excessive unemployment rate in the economy and spare capacity put downward pressure on wages, wages decreases, firms' cost of production decreases meaning that they are able to produce more, shifting  $SRAS_1$  to  $SRAS_2$ , reaching new equilibrium c, increasing output from  $y_{rec}$  to  $y_p$  to come back to  $LRAS$  with a decreased

price level at  $p_3$  compare to  $p_1$ . The decreased price level may serve as an incentive to consumers to purchase more goods and services as now their purchasing power increases, represented as an expansion along the  $AD_2$ , quantity demanded increase from  $y_{rec}$  to  $y_p$ .

- (b) Evaluate the view that an increase in aggregate demand will always be inflationary

**2016 May TZ1**

Section B



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3.

- (a) Explain how an increase in the level of taxation can influence the level of aggregate demand in an economy. [10]
- (b) Evaluate the effectiveness of fiscal policy in promoting economic activity during a recession. [15]

4.

- (a) Using the Keynesian AD/AS diagram, explain why an economy may be in equilibrium at any level of real output. [10]
- (b) Evaluate the view that increased investment is the most important factor in achieving a faster rate of economic growth. [15]

### 2016 May TZ2

#### Section B

3.

- (a) Explain the impact of automatic stabilizers on an economy. [10]
- (b) Evaluate the effectiveness of fiscal policy in achieving economic growth. [15]

Refer to 2018 May TZ1 ? ? ?

4.

- (a) Using the Keynesian AD/AS diagram, explain why an economy may be in equilibrium at any level of real output. [10]
- (b) Evaluate the view that increased investment is the most important factor in achieving a faster rate of economic growth. [15]

### 2016 November

#### Section B

3.

- (a) Explain how expansionary monetary policy might lead to a rise in inflation
- (b) Discuss the view that the most significant impact of high inflation in a country is a loss of export competitiveness

4.

- (a) Explain what effect an increase in interest rate might have on unemployment
- (b) Evaluate the effectiveness of fiscal policy as a tool to reduce unemployment

Refer to 2018 May TZ2

### 2017 May TZ1

3.

- (a) Explain the impact that a fall in the world price of oil might have on aggregate supply and gross domestic product (GDP) in an economy. [10]
  - Cost of production decreases as oil price decreases

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- For oil producer countries: e.g Russia which has a devastating recession, GDP dramatically dropped

(b) Evaluate the view that economic growth is best achieved through improvements in technology. [15]

4.

- (a) Explain why a high rate of inflation may negatively affect both a country's export competitiveness and the level of capital investment by firms. [10]

**Refer to 2016 Nov**

- (b) Discuss the view that the use of monetary policy is always the best way to reduce inflation. [15]

**2017 May TZ2**

3.

- (a) Explain how equilibrium interest rates are determined in an economy. [10]  
(b) Discuss whether an increase in interest rates is the most effective way of reducing the rate of inflation in an economy. [15]

4.

- (a) Explain the cause of cyclical (demand-deficient) unemployment. [10]  
(b) Discuss the view that the most significant consequence of unemployment is the loss of tax revenue for the government. [15]

**2017 November**

3.

- (a) Explain why structural unemployment may occur in an economy. [10]

**Refer to 2018 May TZ2**

- (b) Discuss the view that the best way to reduce unemployment is through education and training. [15]

**Refer to 2018 May TZ2**

4.

- (a) Explain how short-term fluctuations in the level of economic activity may be evened out through the impact of automatic stabilizers. [10]  
(b) Evaluate the view that the use of fiscal policy is the most effective way of reducing the rate of inflation in an economy. [15]

**2018 May TZ1**

3.

- (a) Explain the possible impact of an increase in wealth and consumer confidence on aggregate demand. [10]

(b) Examine why, in contrast to the monetarist/new classical model, the economy will not automatically return to the full employment level of output in the Keynesian model. [15]

4.

(a) Explain how expansionary fiscal policy could be used to close a deflationary (recessionary) gap.

**Refer to 2016 May TZ1**

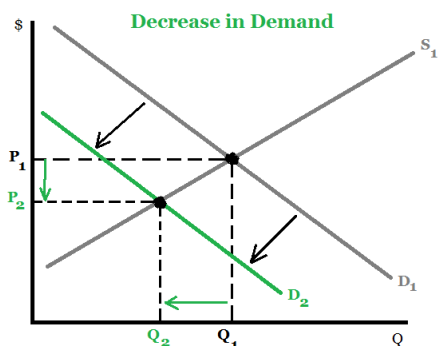
(b) Evaluate the view that fiscal policy is the most effective way of achieving long-term economic growth. [15]

**2018 May TZ 2**

**3. (a) Explain why structural unemployment might occur in an economy. [10]**

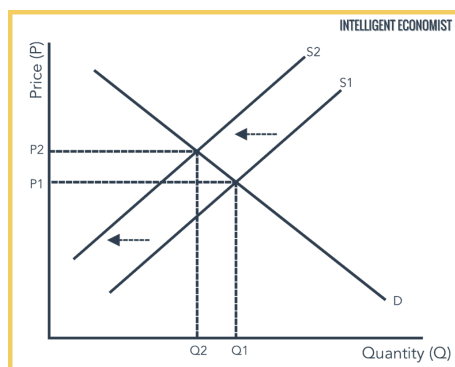
Unemployment is the people above the age of 15 who are actively looking for a job and willing and able to work that are not engaged in the production process. Structural unemployment occurs when there is a job mismatch, it can be caused by:

-Demand alters: the invention of new technology



For example, due to the invention of new technology such as portable photo printer, less people will go to professional photo studio such as Kodak. Thus the demand for photo print decreases dramatically from  $D_1$  to  $D_2$ , forcing many firms in the industry to shut down as it is no longer as profitable, revenue decrease from  $P_1 \cdot Q_1$  to  $P_2 \cdot Q_2$ , send as signals to producers. As derived demand (depended on the demand for photo printing) for labour decreases due to a decreased volume of goods produced in economy, skills are not in demand anymore, many people may become structurally unemployed. They can't transfer skills easily to work in other areas of production with labour shortage.

-geographical changes (market rigidities)



Firms will sometimes outsource their factories to other countries where the cost of production is lower. Thus the local workers may suffer as the work opportunities decrease. For example, due to the high cost of production in Australia, firms moved most of their clothing industries to other countries such as Bangladesh and China where the cost of production is lower. Thus the supply for clothes domestically decreased from  $S_1$  to  $S_2$ , Quantity supplied decreased from  $Q_1$  to  $Q_2$ . In a competitive market, consumers may bid up the price as there are shortages now at  $P_1$ , price increases to  $P_2$ . Other substitutes from China are cheaper and more attractive, resulting in the contraction along the demand curve. As more firms choose to operate in other developing countries, the derived demand for

labour in the country will decrease, lots of workers may lose their job, causing structural unemployment as they cannot fill up other jobs in the economy especially if they are old and less able to work.

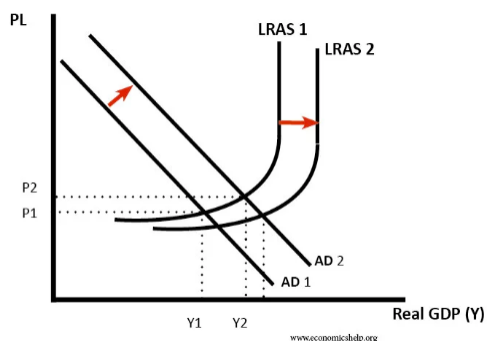
Government intervention(e.g. Minimum wage)

- Price floor
- Permanent surplus of labour in the market
- Australia \$18/per hour

**(b) Evaluate government policies to deal with the different types of unemployment. [15]**

There are four types of unemployment and government can mainly direct their policies to two types: structural unemployment (job mismatch) and cyclical unemployment (resulted from weak AD for goods and services in the economy). AS policies are government initiatives to boost productivity affect potential output, achieve the four economic goals: low inflation, increased economic growth, full employment and increased equity in the distribution of income.

- Investment in human capital (education and training)
  - Decrease structural unemployment in long run
  - Decrease cyclical in SR, (in SR increase AD)



Interventionist policies assumes market by itself is not efficient and needs government intervention. One key strength of the policy is that it can address the underlying causes of structural unemployment and **target sectors of the economy**. For example in Australia, the Australian skilling Fund provide 1.5 billion on investment of education and vocational training. They aim to target sectors of the economy where demand for labour is high and industries with labour shortages so that all labour resources can be allocated to the highest-end use sectors. In the short run, as the skills of labour increases, people can work in more value-adding

jobs and become employed. Their income increases and their buying power increases which means that they can purchase more goods and services in the market. The MPC (increase in one dollar of income, the % spend in the economy) is high especially for low-income earners which means that they would reinject most of their income(injection) into the economy, increasing AD from AD1 to AD2. As demand for products increases, the derived demand (demand dependent on volume of goods and services) for labour increases, decreases the cyclical unemployment.

As productivity (volume of goods and services produced per unit of time) of workers increased due to vocational training, each unit of real labour cost decreases for firms. Firms may become more international competitive as represented in expansion of the AD, increased volumes of goods and services demanded requires more labour force and resulting in further decrease in unemployment.

- Investment in infrastructure (increase AD)
  - Decrease cyclical unemployment

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Spending on G2 will have the greatest long term effect on the economy, the spending on infrastructure adds to productive capacity of the economy and therefore it enables greater production of goods and services in the future. Good infrastructure may also help private businesses to lower their costs of production which may also help to improve Australia's international competitiveness. For example, the Australian government is building new metro lanes, it will require hire workers to build the lanes, resulting in decrease in cyclical unemployment.

### Labour market reform

In the long run, with a more skilled labour force, job vacancies more likely be filled allowing for businesses to produce more goods and services at a lower costs resulting in an increase in productive capacity (From AS1 to AS2), where aggregate supply is the total quantity of goods and services produced in an economy over a particular time period, at different price levels. Thus In the long-run, with workers trained in expanding sectors where labour shortages are faced and growth is stunted, they may gain enhanced productivity and employability. This may reduce real unit labour costs, incentivising firms who now have a greater willingness and ability to invest and supply, and thus lower structural unemployment.

One key weakness of the interventionist policies is that it may target the wrong area and is not effective to decrease unemployment rate.

TAFE in Australia target industries with low labour demand such as the tourism industries which spends billions of government revenue. (opportunity cost exists)

Can be better utilised to train workers in other sectors

- Centralised to decentralised wage system (Workers now can discuss their contracts with firms)
- Structural unemployment
- Alteration of the tax mix
  - Decrease company tax/ business tax
  - Encourage investment
  - Encourage research and development

4.

**(a)** Explain how expansionary fiscal policy could be used to close a deflationary (recessionary) gap. [10]

**Refer to 2013 May TZ2**

**(b)** Evaluate the view that fiscal policy is the most effective way of achieving long-term economic growth. [15]

**Refer to 2018 May TZ1**

**2018 November**

3.

**(a)** Using the concept of the multiplier, explain how an increase in investment might affect aggregate demand. [10]

**(b)** Discuss the effectiveness of supply-side policies in reducing unemployment. [15]

4.

(a) Explain the potential effects on the economic growth rate from a substantial increase in the number of skilled people of working age entering a country. [10]

(b) Discuss the view that, apart from indicating economic growth rates over time, national income statistics are of little use. [15]

**Refer to 2014 Nov TZ0**