

# ECONOMIC FUNDAMENTALS IN AUSTRALIA

A text for students of VCE Economics Units 3 and 4  
5<sup>th</sup> edition



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### **Disclaimers**

Every attempt has been made by the authors to ensure that the content contained in this publication is consistent with the Economics VCE Study Design (accreditation period 2017 – 2021) produced by the Victorian Curriculum and Assessment Authority (VCAA). The publisher and authors assert that there is no direct connection between this publication and the VCAA.

Students and teachers are urged to supplement the use of this text with the official Economics VCE Study Design and other resources, including internet sites referred to within the text, other texts, print and electronic media. All internet sites referred to were operational at the time of going to print. The CPAP Study Guide to VCE Economics is a companion resource to this text and is updated annually.

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# About the authors

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## A note to teachers and students

The authors have written this text to closely reflect the requirements of the study as outlined in the VCAA VCE Economics Study Design (2017-2021). The Study Design can be downloaded at [www.vcaa.vic.edu.au/vce/studies](http://www.vcaa.vic.edu.au/vce/studies) and it contains information about the required content for a course of study in VCE Units 3 and 4 Economics. Unit 3 comprises three areas of study (AOS), AOS 1, 2 and 3, while Unit 4 comprises two areas of study, AOS 1 and 2. For each area of study, students are required to demonstrate an understanding of each of the dot points contained under the heading 'key knowledge.' They should also be able to demonstrate the 'key skills' for each AOS.

The 'key knowledge' (and 'key skills') dot points are included below in tables 1 to 7, where each key knowledge point is cross referenced to the relevant section in the text. It will therefore provide a useful guide for teachers when preparing assessment tasks or exercises and a handy guide for students when preparing for assessment tasks, including the end of year exam.

**Table 1**  
**Unit 3 Australia's economic prosperity**  
**Area of Study 1: An introduction to microeconomics: the market system, resource allocation and government intervention**

	<b>Key knowledge</b>	<b>Chapter references</b>	<b>Tick when learned</b>
1	relative scarcity: needs, wants, resources and opportunity cost	1.1-1.6	
2	the nature of, and conditions for, a perfectly competitive market	2.1 - 2.2	
3	the law of demand and the demand curve including movements along, and shifts of, the demand curve	2.3	
4	factors likely to affect demand and the position of the demand curve: changes in disposable income, the prices of substitutes and complements, preferences and tastes, interest rates, changes in population and consumer confidence	2.4	
5	the law of supply and the supply curve including movements along, and shifts of, the supply curve	2.5	
6	factors likely to affect supply and the position of the supply curve: changes in the cost of production, technological change, productivity growth and climatic conditions	2.6	
7	the effects of changes in supply and demand on equilibrium prices and quantity traded	2.7 - 2.8	
8	the role of relative prices in markets on the allocation of resources and the effect on living standards	2.9 - 2.10	
9	the meaning and significance of price elasticity of demand and supply	2.11 + 2.13	
10	factors affecting price elasticity of demand: degree of necessity, availability of substitutes, proportion of income and time	2.12	
11	factors affecting price elasticity of supply: spare capacity, production period and durability of goods	2.14	
12	the meaning and significance of economic efficiency: allocative efficiency, productive efficiency, dynamic efficiency and inter-temporal efficiency	3.1	
13	the effect of competitive markets on the efficiency of resource allocation	3.1	
14	reasons for market failure: public goods, externalities, asymmetric information and common access resources	3.2	
15	the role and effect of indirect taxation, subsidies, government regulations and government advertising as forms of government intervention in the market to address market failure	3.2	
16	one contemporary example of government intervention in markets that unintentionally leads to a decrease in the efficiency of resource allocation	3.3	

**Table 2**  
**Unit 3 Australia's economic prosperity**  
**Area of Study 2: Domestic macroeconomic goals**

<b>Key knowledge</b>		<b>Chapter references</b>	<b>Tick when learned</b>
<b><i>The nature and purpose of economic activity</i></b>			
17	the difference between material and non-material living standards	4.2	
18	factors that may influence living standards including access to goods and services, environmental quality, physical and mental health, life expectancy, crime rates and literacy rates	4.2	
19	the circular flow model of income including the role of households, businesses, government, financial institutions and the external sector in an open contemporary macroeconomy	4.3	
20	the nature and causes of the business cycle	4.4	
21	the meaning and importance of aggregate demand and the factors that may influence the level of aggregate demand in the economy: changes in the general level of prices, disposable income, interest rates, consumer confidence, business confidence, the exchange rate and rates of economic growth overseas	4.5 - 4.6	
22	the aggregate demand curve	4.8	
23	the meaning and importance of aggregate supply and the factors that may influence the level of aggregate supply in the economy: changes in the general level of prices, quantity and quality of the factors of production, cost of production, technological change, productivity growth, exchange rates and climatic conditions	4.7	
24	the aggregate supply curve	4.8	
25	the effects of changes in aggregate demand and aggregate supply on the level of economic growth, employment and price levels	4.9	
<b><i>The Australian Government's domestic macroeconomic goals</i></b>			
26	the meaning of the goal of low inflation (price stability)	7.1	
27	measurement of the inflation rate using the Consumer Price Index (CPI) including the difference between the headline and underlying (core) rate of inflation	7.2	
28	causes of inflation including demand and cost inflation	7.4	
29	consequences of a high inflation rate: erosion of purchasing power, redistributive effects, resource misallocation, savings and investment and international competitiveness	7.3	
30	the meaning of the goal of strong and sustainable economic growth	5.1	
31	measurement of the rate of economic growth using real Gross Domestic Product (GDP)	5.2	
32	the reasons for pursuing strong and sustainable economic growth including lowering of the unemployment rate, growth in real income and increased ability of government to provide essential services	5.3	
33	the meaning of the goal of full employment and classifications within the labour force: employed, unemployed, hidden unemployment, disguised or under-employed	6.1-6.2	
34	measurement of the labour force including the participation rate, the unemployment rate and the labour force underutilisation rate	6.3	
35	types and causes of unemployment: cyclical, structural, frictional, seasonal and hard-core unemployment	6.4	
36	the consequences of unemployment including loss of GDP, loss of tax revenue, reductions in living standards and greater income inequality	6.5	
37	aggregate demand and aggregate supply factors that have influenced inflation, economic growth, the unemployment rate and living standards in the past two years.	5.4 + 6.6 +7.5	

**Table 3**  
**Unit 3 Australia's economic prosperity**  
**Area of Study 3: Australia and the world economy**

<b>Key knowledge</b>		<b>Chapter references</b>	<b>Tick when learned</b>
38	the relationship between trade and living standards including lower prices for consumers, greater choice for consumers, the ability of businesses to achieve economies of scale and access to more resources for business and government	8.1	
39	the balance of payments and its components	8.2	
40	causes of Australia's current account deficit including cyclical and structural factors	8.3	
41	the relationship between the current account and the capital and financial account	8.2	
42	the composition and cause of net foreign debt and net foreign equities	8.4	
43	the terms of trade: meaning and measurement and the factors that may influence the terms of trade	8.5	
44	the effect of movements in the terms of trade on the current account balance, the domestic macroeconomic goals and living standards	8.5	
45	factors affecting the value of the exchange rate including relative interest rates, demand for exports and imports, capital flows, the terms of trade and relative rates of inflation	8.6	
46	the effect of exchange rate movements on the current account balance, the domestic macroeconomic goals and living standards	8.7	
47	factors that may influence Australia's international competitiveness including productivity, production costs, availability of natural resources, exchange rates and relative rates of inflation, and the effect of these factors on domestic macroeconomic goals and living standards	8.8	
48	the effect of trade liberalisation on Australia's international competitiveness, domestic macroeconomic goals and living standards	8.9	

**Table 4**  
**Unit 3 Key skills**

<b>The key skills across Unit 3 AOS 1-3</b>		<b>Area of Study</b>	<b>Tick when learned</b>
1	define key economic concepts and terms and use them appropriately	1 and 2	
2	construct and interpret demand and supply diagrams	1	
3	interpret and analyse statistical and graphical data	1	
4	evaluate the role of the market in allocating resources	1	
5	explain the effect of government intervention in markets	1	
6	compare alternative economic viewpoints to form conclusions	1	
7	calculate relevant economic indicators using real or hypothetical data	2 & 3	
8	explain trends, patterns, similarities and differences in economic data and other information	2 & 3	
9	apply economic concepts and theories to explain the nature and importance of the Australian Government's domestic macroeconomic goals	2	
10	analyse economic relationships through the interpretation of data, graphical trends, patterns and other information	2	
11	explain key international economic relationships and how they may affect living standards	3	
12	access and interpret, and draw conclusions from, information gathered from a range of sources	3	

**Table 5**  
**Unit 4 Managing the economy**  
**Area of Study 1: Aggregate demand policies and domestic economic stability**

	<b>Key knowledge</b>	Chapter references	Tick when learned
49	the need for aggregate demand policies in terms of stabilising the business cycle	9.10 + 12.3	
<b>Budgetary policy</b>			
50	sources of government revenue including direct and indirect taxation, revenue from government businesses and the sale of government assets	9.1	
51	types of government expenses including government current and capital expenditure and transfer payments	9.3	
52	the budget outcome: balanced, deficit or surplus	9.4	
53	the ways government may finance a deficit or utilise a surplus	9.9	
54	the relationship between the budget outcome and the level of government (public) debt	9.9	
55	the role of automatic stabilisers (cyclical component of the budget) in influencing aggregate demand and stabilising the business cycle	9.5	
56	the role of discretionary stabilisers (structural component of the budget) in influencing aggregate demand and stabilising the business cycle	9.8	
57	the effect of automatic and discretionary changes in the budget on the budget outcome and government (public) debt	9.5 + 10.1	
58	the stance of budgetary policy: expansionary or contractionary	9.8	
59	the effect of budget initiatives from the past two years on the Australian Government's domestic macroeconomic goals of strong and sustainable growth, full employment and low inflation	10.2	
60	the strengths and weaknesses of using budgetary policy to achieve the Australian Government's domestic macroeconomic goals and how these goals may affect living standards	9.12 + 10.3	
<b>Monetary policy</b>			
61	the role of the RBA with respect to monetary policy as outlined in its charter	11.1 - 11.2	
62	the role of open market operations in altering interest rates	11.3-11.5	
63	transmission mechanisms of monetary policy and their influence on the level of aggregate demand including savings and investment, cash flow, availability of credit, exchange rate movements and asset prices	11.7	
64	the stance of monetary policy: expansionary or contractionary	11.6	
65	the focus of monetary policy from the past two years on the levels of aggregate demand and the Australian Government's domestic macroeconomic goals of strong and sustainable economic growth, full employment and low inflation	12.1-12.5	
66	the strengths and weaknesses of using monetary policy to achieve the Australian Government's domestic macroeconomic goals and how these goals may affect living standards.	11.9	

**Table 6**  
**Unit 4 Managing the economy**  
**Area of Study 2: Aggregate supply policies**

<b>Key knowledge</b>		<b>Chapter references</b>	<b>Tick when learned</b>
67	the nature, operation and aims of aggregate supply policies and their relationship to the domestic macroeconomic goals, international competitiveness and living standards	13.1 - 13.2 + 13.4	
68	the relationship between the efficient allocation of resources and aggregate supply	13.3	
69	how the following aspects of budgetary policy are designed to influence aggregate supply and the achievement of domestic macroeconomic goals: <ul style="list-style-type: none"> <li>• spending on training and education</li> <li>• research and development grants</li> <li>• subsidies</li> <li>• investment in infrastructure</li> </ul>	13.5a 13.5b 13.5c 13.5d	
70	how welfare and tax reform policies are designed to influence aggregate supply and living standards	13.6	
71	the effect of immigration policies on the labour market and aggregate supply, and the way in which this influences the achievement of domestic macroeconomic goals	13.8	
72	the strengths and weaknesses of using aggregate supply policies to achieve the Australian Government's domestic macroeconomic goals and how these goals may affect living standards	13.7 + 13.9	

**Table 7**  
**Unit 4 Key skills**

<b>The key skills across Unit 4 AOS 1-2</b>		<b>Area of Study</b>	<b>Tick when learned</b>
1	define and use key economic concepts and terms relating to the Australian Government's aggregate demand policies	1	
2	gather relevant data and information about the nature and operation of aggregate demand policies in Australia	1	
3	discuss and analyse the effect of contemporary factors on the setting of aggregate demand policies	1	
4	evaluate the strengths and weaknesses of aggregate demand policies in achieving the Australian Government's domestic macroeconomic goals.	1	
5	define key economic concepts and terms and use them appropriately	1 & 2	
6	describe the aims of aggregate supply policies in terms of the domestic macroeconomic goals and living standards	2	
7	gather relevant data and information about the nature and operation of aggregate supply policies in Australia	2	
8	analyse the effect of aggregate supply policies on the domestic macroeconomic goals and living standards	2	
9	discuss the strengths and weaknesses of aggregate supply policies	2	

### Proposed timeline

#### Unit 3 – Australia's economic prosperity

**Area of Study 1:** approximately 6 - 7 weeks

**Area of Study 2:** approximately 5 - 6 weeks

**Area of Study 3:** approximately 4 - 5 weeks

#### Unit 4 – Managing the economy

**Area of Study 1:** approximately 8-9 weeks

**Area of Study 2:** approximately 6-7 weeks

**Revision:** 2 - 4 weeks.



# Assessment

Teachers are required to provide a score for each outcome in each of Units 3 and 4, which represents an assessment of the student's achievement. The score must be based on the teacher's assessment of the level of performance of each student on the outcomes for the unit specified in the Study Design. These outcomes for each unit are linked to the key knowledge and skills as specified in the Study Design and re-produced on the previous pages.

Teachers must select assessment tasks from the designated list for each outcome published in the Study Design. School-assessed Coursework for the outcomes in Unit 3 will contribute 25 per cent to the student's study score. School-assessed Coursework for the outcomes in Unit 4 will contribute a further 25 per cent to the student's study score. The external examination will contribute the final 50 per cent to the student's study score.

Unit 3 Assessment		
Outcome statement	Marks allocated*	Assessment tasks
<b>Outcome 1</b> Explain how markets operate to allocate resources, and discuss the effect of government intervention on market outcomes.	40	The student's performance on each outcome is assessed using one or more of the following: <ul style="list-style-type: none"> <li>a folio of applied economic exercises</li> <li>an essay</li> <li>a report</li> <li>media analysis</li> <li>a case study</li> <li>structured questions</li> </ul>
<b>Outcome 2</b> Analyse key contemporary factors that may have influenced the Australian Government's domestic macroeconomic goals over the past two years and discuss how achievement of these goals may affect living standards.	30	
<b>Outcome 3</b> Explain the factors that may influence Australia's International transactions and evaluate how international transactions and trade liberalisation may influence the current account balance, the Australian Government's domestic macroeconomic goals and living standards in Australia.	30	
<b>Total marks</b>	<b>100</b>	
*School-assessed Coursework for Unit 3 contributes 25 per cent to the study score.		

Unit 4 Assessment		
Outcome statement	Marks allocated*	Assessment tasks
<b>Outcome 1</b> Discuss the nature and operation of aggregate demand policies and analyse how the policies may influence the Australian Government's domestic macroeconomic goals and living standards.	50	The student's performance on each outcome is assessed using one or more of the following: <ul style="list-style-type: none"> <li>an essay</li> <li>a report</li> <li>problem-solving exercises</li> <li>a folio of media commentaries</li> <li>a folio of applied economic exercises</li> <li>structured questions</li> </ul>
<b>Outcome 2</b> Discuss the nature and operation of aggregate supply policies and analyse how the policies may influence the Australian Government's domestic macroeconomic goals and living standards.	50	
<b>Total marks</b>	<b>100</b>	
*School-assessed Coursework for Unit 4 contributes 25 per cent to the study score.		

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