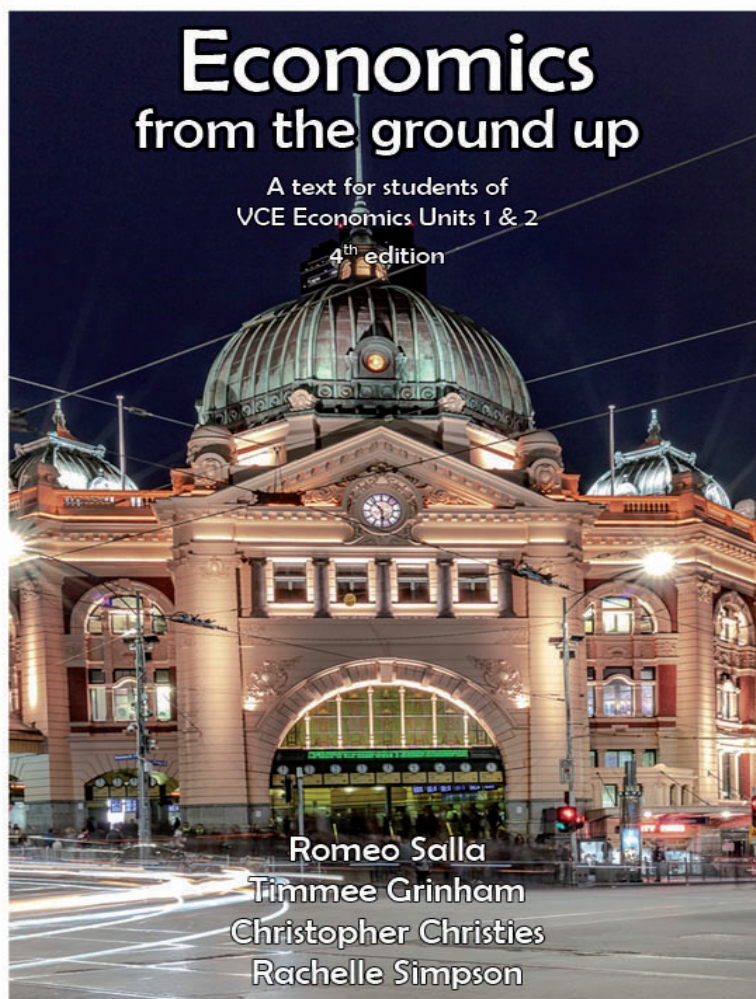


# Economics from the ground up

A text for students of  
VCE Economics Units 1 and 2

4<sup>th</sup> edition



Commerce Presentations and Publications (CPAP)

206/1 Queens Rd

St Kilda Rd Towers

Melbourne Vic 3004

Tel: 03 9866 2289

Fax: 03 9005 2717

Email: [cpap@commpap.com](mailto:cpap@commpap.com)

Web: [www.commpap.com](http://www.commpap.com)

Copyright © CPAP

First published 2013

Second edition 2017

Third edition 2020

Fourth edition 2023

### **Reproduction and communication for educational purposes**

The Australian Copyright Act 1968 (the Act) allows a maximum of one chapter or 10% of the pages of this book, whichever is greater, to be reproduced and/or communicated by any educational institution for its educational purposes, provided that the educational institution (or the body that administers it) has given a remuneration notice to Copyright Agency Limited (CAL) under the Act. For details of the CAL license visit [www.copyright.com.au](http://www.copyright.com.au).

### **Reproduction and communication for other purposes**

Except as permitted under the Act (for example, any fair dealing for the purposes of study, research, criticism or review), no part of this book may be reproduced, stored in a retrieval system, communicated or transmitted in any form or by any means without prior written permission. All enquiries should be made to the publisher at the above address.

### **Acknowledgements**

The authors and publisher would like to thank government agencies for the use of statistical material collected from the Reserve Bank of Australia and the Australian Bureau of Statistics. All charts and data have been sourced from these organisations via their respective websites at [www.rba.gov.au](http://www.rba.gov.au) and [www.abs.gov.au](http://www.abs.gov.au), unless otherwise stated. The authors would like to thank their families who have been forced to make further sacrifices to enable the fourth edition to be written.

Cover design by Marie Williams [[www.prolensphotography.com.au](http://www.prolensphotography.com.au)]

### **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 2023-2027) 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.

Printed in China

[www.ecogroundup.com.au](http://www.ecogroundup.com.au)

[www.commpap.com](http://www.commpap.com)

**ISBN: 978-1-921813-69-6**

## About the authors

**Romeo Salla** completed Honours and Masters degrees in Commerce (Economics major) at the University of Melbourne before moving to Canberra to work as an Economist with the Commonwealth Department of Treasury. After a few years he was promoted within the federal bureaucracy to the position of Senior Economist with the Industry Commission (now Productivity Commission). Since 1996 he has been employed as a Senior Teacher and Head of Faculty at large private schools in Melbourne, teaching VCE and IB Economics, as well as working more widely in Economics education. Romeo has held positions of responsibility with the Victorian Curriculum and Assessment Authority (VCAA) as an assessor of final examinations, including as Chief Assessor, and is also the founder of the website [www.economicstutor.com.au](http://www.economicstutor.com.au). He is also a co-author of the CPAP Study Guide to VCE Economics and co-author of *Economic Fundamentals in Australia* (CPAP). Romeo regularly presents to Economics teachers and students on behalf of the VCTA and CPAP and is a prolific writer of assessment tasks and practice examinations. He has also developed the popular smartphone App (Economics Tutor), containing 1000+ multiple choice and short answer questions.

**Timmee Grinham** completed a Bachelor of Economics (Economics and Politics majors) with Honours in Politics and a Graduate Diploma in Education at Monash University, Melbourne. Following her undergraduate studies, Timmee worked towards a PhD in Women's Studies, during which time she was employed as a Tutor and sessional Lecturer. Timmee was the Assistant Editor of the Australian Tax Forum during her undergraduate studies, and she worked as an editor for the Monash Postgraduate Association. Timmee has worked as a senior Commerce (Economics and Business Management) and Humanities teacher at several government and independent schools. Timmee contributes to various publications and presents professional development sessions to other teachers of Economics. She is also author of the quarterly CPAP Updates for VCE Economics Units 3 and 4 and co-author of *Economic Fundamentals in Australia* (CPAP). Timmee has worked as an assessor of final examinations in VCE Economics (including as Assistant Chief Assessor) and Business Management, and chairs the Economics Advisory Group of the VCTA. Since 2017, Timmee has served as a member of the Reserve Bank of Australia Educators Advisory Panel. Timmee was a member of the panel of experts that developed the new VCE Economics study design.

**Christopher Christies** completed a Bachelor of Economics degree (Economics major) and a Graduate Diploma in Education at Monash University. He has taught in government, Catholic and independent schools, and in both co-educational and single gender settings for over 25 years. During this time he has also served as Head of Humanities & Business Studies. Since 2014 he has taught at Penleigh and Essendon Grammar School, where he is also Year 12 Coordinator. Christopher has held positions of responsibility with the Victorian Curriculum and Assessment Authority (VCAA) as an assessor of final examinations (including as Assistant Chief Assessor) and was a member of the panel of experts that developed the new VCE Economics Study Design and advice for teachers. He is a regular contributor to the VCTA's COMPAK journal and writes examinations for commercial publications.

**Rachelle Simpson** discovered her passion for Economics in high school in NSW and went onto complete a Bachelor of Economics at the Australian National University. Following this she completed a Master of Business in Marketing at Charles Sturt University and then a PhD in Applied Economics at Victoria University where she examined the relationship between globalisation and development in the world's poorest countries. Rachelle's particular areas of interest are trade, how countries achieve economic progress and economic history. Prior to becoming a teacher, Rachelle worked in the finance industry sectors of banking, superannuation and insurance and held leadership roles in operations, compliance, business transformation and project delivery. Since becoming a teacher Rachelle has taught in both independent and catholic schools in Victoria. Her teaching experience encompasses a range of Commerce and Humanities subjects including the VCE subjects of Economics, Accounting, Business Management and Australian and Global Politics. Rachelle is on the Victorian Commercial Teacher's Association Economics Advisory Committee (VCTA). She has also contributed to VCTA's Compak journal and is an assessor of VCE Economics examinations for the Victorian Curriculum and Assessment Authority (VCAA).

# A note to teachers and students

The approach taken when writing this text has been to provide a resource that can engage and stimulate students of Economics as well as make the job of teaching the course relatively straightforward. We have written each chapter to closely reflect the requirements of the VCE Economics Unit 1 and 2 course as outlined in the VCAA VCE Economics Study Design (2023-2027). The text is packed with colourful exercises, case studies, review questions and crosswords that are supported by a stand-alone website ([www.ecogroundup.com.au](http://www.ecogroundup.com.au)) dedicated solely to users of the text.

The richness and breadth of the activities enables teachers to ‘pick and choose’ activities based on the interests of their class or the direction of their lessons. For example, teachers might like to deliver particular components of the course through the provision of activities, such as Application Exercise 3b: Black markets, Application Exercise 4l: price discrimination at cinemas or Application Exercise 7d: The gender pay gap. There are hundreds of like activities through the text, carefully placed to add life and relevance to each of the key knowledge points from the Study Design. They also assist students to develop the key skills outlined in the Study Design, through the collection, interpretation and analysis of economic data.

It has been our goal as both teachers and textbook writers to provide as many varied and engaging activities as possible for students. It is not our expectation that teachers would use all of the activities (or even all of the sections) in each chapter. Some sections contain multiple examples from each key knowledge or key skill area of the Study Design. In the case of Unit 2, students are only required to investigate two of the four economic issues covered in chapters 7-10, but they are encouraged to explore the content in all of these chapters to develop a greater appreciation of the economic issues facing Australia and the globe.

We hope that by including a broad array of activities, this book will promote the enjoyment of studying Economics to students of all abilities, all interest areas and many different geographic locations. We encourage teachers to construct their course with attention to the required key knowledge and skills content of the subject, along with the interests of their students.

In some respects, the structure of the text enables it to be used as a series of ‘lesson plans’, and the compact layout facilitates ‘self-paced learning’. Students can be directed to work through a section of the text, completing the review questions at the end of each section and attempting some or all of the exercises that are specifically designed for applied learning. This approach helps students to develop the key knowledge and skills for each of the five areas of study.

We hope that the breadth and depth of content in this textbook will enhance both student and teacher enjoyment of this terrific subject.

**Romeo Salla**  
**Timmee Grinham**  
**Christopher Christies**  
**Rachelle Simpson**

## Unit 1 Economic decision-making

Unit 1 AOS 1 Key knowledge: Thinking like an economist	Chapter reference Section	Tick when understood
<b>Introductory concepts</b>		
1. the two main branches of economics: microeconomics and macroeconomics	1.1	
2. the two main forms of economic analyses: positive economics and normative economics	1.1	
3. resources (factors of production such as land, labour and capital) used to satisfy needs and wants	1.2	
4. the basic economic problem of relative scarcity and the need for economic decision-making	1.2	
5. the concept and applications of opportunity cost	1.3	
6. the production possibility model to illustrate the concepts of scarcity, choice, opportunity cost, efficiency and under-utilisation of resources	1.4	
7. the need for trade-offs and cost-benefit analysis and their relationship to opportunity cost	1.7	
8. the three basic economic questions: what and how much to produce, how to produce, and for whom to produce	1.5	
9. how different economic systems, including market economies, planned economies, mixed economies and traditional economic systems, may answer the three key economic questions	1.5	
10. the three-sector circular flow model of the economy, including consumers/households, producers/businesses and government	1.6	
11. the purpose of economic activity and the effect on material and non-material living standards	1.6	
<b>The economic agents</b>		
12. economic agents and the concept of the public and private sectors of the economy	2.1	
13. the traditional economic viewpoint of consumer behaviour: self-interest, maximisation of utility, rationality, informed decision-making and marginal benefits from consumption	2.2	
14. the ways consumers and workers might respond to incentives and disincentives, including taxes and tax rebates, subsidies and regulations	2.3	
15. the traditional economic viewpoint of business in the economy: profit maximisation	2.4	
16. the ways businesses might respond to incentives and disincentives, including taxes and tax rebates, subsidies and regulations	2.5	
17. the traditional economic viewpoint of the government in the economy: maximisation of living standards	2.6	
18. the role of government in economic stabilisation, improving efficiency in resource allocation and redistribution of income to improve living standards	2.7	

Unit 1 AOS 1 Key skills: Thinking like an economist	Tick when mastered
define key economic concepts and terms and use them appropriately	
apply economic theory to make economic predictions and create responses that communicate economic meaning	
gather, synthesise and use economic data and information from a wide range of sources to analyse economic issues and assess the effect of economic decisions on relevant economic agents	
construct, interpret and apply economic models to analyse the consequences of economic decisions	
identify the trade-offs and discuss the costs and benefits associated with a range of economic decisions by drawing conclusions based on economic criteria	

## Unit 1 Economic decision-making

<b>Unit 1 AOS 2 Key knowledge: Decision-making in markets</b>	Chapter reference Section	Tick when understood
19. the assumptions of a perfectly competitive market system	3.1	
20. the law of demand and the demand curve	3.2	
21. the effect on demand and the position of the demand curve by non-price factors, including changes in disposable income, the prices of substitutes and complements, tastes and preferences, interest rates, population and demographics, and consumer confidence	3.3	
22. the distinction between a movement along the demand curve and a shift of the demand curve	3.4	
23. the law of supply and the supply curve	3.5	
24. the effect on supply and the position of the supply curve by non-price factors, including changes in the costs of production, technology, productivity, and climatic conditions and other disruptions	3.6	
25. the distinction between a movement along the supply curve and a shift of the supply curve	3.7	
26. the effects of changes in demand and supply on equilibrium prices and quantities	3.8	
27. the role of the market mechanism and relative prices in the allocation of resources in a market-based economy	3.9	
28. the degree of market power in different markets, such as perfect competition, monopolistic competition, oligopoly and monopoly, and the effect on prices, resource allocation and living standards	4.3 - 4.5	
29. the strategies businesses may use to increase profit, including price discrimination, multiple branding or anti-competitive behaviour as outlined in the <i>Competition and Consumer Act 2010</i>	4.6	
30. one contemporary example of a market, including the degree of competition in that market	4.1 - 4.2	

<b>Unit 1 AOS 2 Key skills: Decision making in markets</b>	Tick when mastered
define key economic concepts and terms and use them appropriately	
gather, synthesise and use economic data and information from a wide range of sources to analyse economics issues and assess the effect of economic decisions	
construct and interpret graphs and diagrams to represent and interpret economic information	
apply economic knowledge, concepts and theories to predict the effect of changes in conditions on market outcomes	
research and synthesise information about a particular market	
analyse the extent of competition in markets by drawing conclusions based on economic criteria.	

## Unit 1 Economic decision-making

<b>Unit 1 AOS 3 Key knowledge: Behavioural economics</b>	Chapter reference Section	Tick when understood
31. key insights of behavioural economics, including bounded rationality, bounded willpower and bounded self-interest	5.1	
32. the differences between traditional economics and behavioural economics	5.2	
33. the effectiveness of strategies used by government to influence consumer behaviours	5.3	
34. the effectiveness of strategies used by producers/businesses to influence consumer behaviours	5.4	

<b>Unit 1 AOS 3 Key skills: Behavioural economics</b>	<b>Tick when mastered</b>
define key economic concepts and terms and use them appropriately	
distinguish between traditional economics and behavioural economics	
apply economic theory to make economic predictions and create responses that communicate economic meaning	
investigate and/or conduct at least one behavioural economics experiment by gathering, synthesising and using economic data and information to report on the findings	
analyse the effectiveness of government and business actions that draw on behavioural economics, using data and economic information to draw conclusions supported by economic reasoning	

## Unit 2 Economic issues and living standards

<b>Unit 2 AOS 1 Key knowledge: Economic activity</b>	<b>Chapter reference Section</b>	<b>Tick when understood</b>
35. the purpose of economic activity	6.1	
36. the meaning of material and non-material living standards	6.1	
37. the five-sector circular flow model of the economy	6.1	
38. the business cycle	6.3	
39. types of economic indicators, such as leading, lagging and coincident	6.3	
40. the relationship between the business cycle and economic indicators	6.3	
41. the meaning and importance of aggregate demand and its components	6.1	
42. the factors that may affect the level of aggregate demand and the level of economic activity	6.4	
43. the meaning and importance of aggregate supply	6.1	
44. the factors that may affect the level of aggregate supply and the level of economic activity	6.4	
45. the measurement of economic growth using changes in real Gross Domestic Product (GDP)	6.1	
46. the potential benefits of economic growth, such as growth in material living standards, improved non-material living standards, employment opportunities and economic development	6.2	
47. the potential costs of economic growth, including boom and bust economic cycles, congestion and pollution, environmental damage, potentially widening inequality and 'influenza'	6.2	
48. the limitations associated with using real GDP and real GDP per capita to measure changes in living standards	6.2	
49. alternative measures of economic activity and living standards	6.2	

<b>Unit 2 AOS 1 Key skills: Economic activity</b>	<b>Tick when mastered</b>
define key economics concepts and terms and use them appropriately	
construct and interpret economic models including the business cycle and the five-sector circular flow model of the economy	
gather, synthesise and use economic data and information from a wide range of sources to analyse economic issues	
identify trends, patterns, similarities and differences in economic data and other information	
discuss the potential costs and benefits associated with increasing economic activity	

## Unit 2 Economic issues and living standards

Unit 2 AOS 2 Key knowledge: Applied economic analysis of local, national and international economic issues	Chapter reference Section	Tick when understood
50. the definition of the selected economic issue, including relevant measures and statistical indicators	Chap 7-10	
51. the reasons the issue is of importance to the economy at a local, national and international level	Chap 7-10	
52. the economic factors influencing the extent of the selected economic issue	Chap 7-10	
53. the different perspectives of households (consumers and workers), business, government and other relevant economic agents regarding the selected economic issue	Chap 7-10	
54. the economic responses undertaken by relevant economic agents at a local, national and international level, to address the economic issue, including government policies	Chap 7-10	

Unit 2 AOS 2 Key skills: Applied economic analysis of local, national and international economic issues	Tick when mastered
define key economic concepts and terms and use them appropriately	
gather, synthesise and use economic information from a range of sources to analyse economic issues	
identify trends, patterns, similarities and differences in economic data and other information to draw conclusions	
evaluate the economic responses undertaken to address economic issues	

### Suggested timelines

#### Unit 1 – Economic decision-making

- Area of Study 1: Thinking like an economist - approximately 7-8 weeks
- Area of Study 2: Decision-making in markets - approximately 7-8 weeks
- Area of Study 3: Behavioural economics - approximately 4-5 weeks

#### Unit 2 – Economics issues and living standards

- Area of Study 1: Economic activity - approximately 6-7 weeks
- Area of Study 2: Applied economic analysis - approximately 12 - 13 weeks

#### Assessment

The award of satisfactory completion for a unit is based on whether the student has demonstrated the set of outcomes specified for the unit. Teachers should use a variety of learning activities and assessment tasks that provide a range of opportunities for students to demonstrate the key knowledge and key skills in the outcomes. Assessment must be a part of the regular teaching and learning program and should be completed mainly in class and within a limited timeframe. For Unit 1, students are required to demonstrate achievement of three outcomes. For Unit 2, students are required to demonstrate achievement of two outcomes. The 'key knowledge' and 'key skills' are included in the tables on the preceding pages, 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 semester examinations.

For further information about assessment consult the VCE Economics Study Design (2023-2027) or visit [www.vcaa.vic.edu.au](http://www.vcaa.vic.edu.au).



# Table of Contents

## Chapter 1

### An introduction to economics

1.1	What is economics?	1
1.2	The basic economic problem of relative scarcity and the need for economic decision making	4
1.3	The concept and applications of opportunity cost	6
1.4	The production possibility curve and its applications	9
1.5	The basic economic questions	12
1.6	The purpose of economic activity and the influence on living standards	14
1.7	The need for trade-offs and cost-benefit analysis	17
1.8	<i>Multiple choice review questions</i>	22
1.9	<i>Chapter crossword puzzle</i>	24
1.10	<i>Chapter summary</i>	25

## Chapter 2

### Economic agents

2.1	Economic agents and the concept of the private and public sectors	27
2.2	The traditional economic viewpoint of consumer behaviour	29
2.3	The ways consumers and workers might respond to positive and negative incentives	31
2.4	The traditional economic viewpoint of business in the economy: profit maximisation	36
2.5	The ways businesses might respond to incentives and disincentives	37
2.6	The traditional economic viewpoint of the government in the economy: maximisation of living standards	40
2.7	The role of government in economic stabilisation, improving efficiency in resource allocation and redistribution of income to improve living standards	40
2.8	<i>Multiple choice review questions</i>	45
2.9	<i>Chapter crossword puzzle</i>	47
2.10	<i>Chapter summary</i>	49

## Chapter 3

### Decision-making in markets

3.1	What is a market?	50
3.2	The law of demand and the demand curve	52
3.3	Non-price factors affecting the demand for goods and services	54
3.4	Movements along the demand curve versus shifts of the demand curve	58
3.5	The law of supply and the supply curve	61
3.6	Non-price factors affecting the supply of goods and services	62
3.7	Movements along the supply curve versus shifts of the supply curve	66
3.8	Effects of changes in demand and supply on equilibrium prices and quantities	69
3.9	The role of relative prices in the allocation of resources	81
3.10	<i>Multiple choice review questions</i>	87
3.11	<i>Chapter crossword puzzle</i>	89
3.12	<i>Chapter summary</i>	90

## Chapter 4

### Market case studies and market structures

4.1	Case study 1: Study of labour markets (extensive)	91
4.2	Case Study 2: Brief study of stock markets	101
4.3	What is meant by market structure and market power?	108
4.4	Different types of market structures	109
4.5	How market structures affect prices, resource allocation and living standards	113
4.6	Strategies businesses employ to increase profitability	117
4.7	<i>Multiple choice review questions</i>	123
4.8	<i>Chapter crossword puzzle</i>	125
4.9	<i>Chapter summary</i>	126

## Chapter 5

### Behavioural economics

5.1	Key insights of behavioural economics, including bounded rationality, bounded willpower and bounded self-interest	128
5.2	The differences between traditional economics and behavioural economics	138
5.3	The effectiveness of strategies used by government to influence consumer behaviours	139
5.4	The effectiveness of strategies used by producers/businesses to influence consumer behaviours	142
5.5	<i>Multiple choice review questions</i>	146
5.6	<i>Chapter crossword puzzle</i>	148
5.7	<i>Chapter summary</i>	149

**Chapter 6****Economic activity**

6.1	The nature and purpose of economic activity	150
6.2	Benefits and costs of economic growth	157
6.3	The business cycle and economic indicators	164
6.4	Aggregate demand and supply factors influencing economic activity	167
6.5	<i>Multiple choice review questions</i>	170
6.6	<i>Chapter crossword puzzle</i>	172
6.7	<i>Chapter summary</i>	173

**Chapter 7****The changing labour market**

7.1	Australian labour markets	175
7.2	Key labour market indicators	180
7.3	Causes and types of unemployment	183
7.4	Consequences of unemployment	187
7.5	Changes in Australia's labour markets	188
7.6	Government policies influencing labour markets	198
7.7	<i>Multiple choice review questions</i>	203
7.8	<i>Chapter crossword puzzle</i>	205
7.9	<i>Chapter summary</i>	206

**Chapter 8****International Trade**

8.1	International trade and financial flows	209
8.2	Key features of Australia's trade and trading relationships	210
8.3	The measurement and recent trends in Australia's trade and financial flows	215
8.4	Australia's trade and financial flows with a key trading partner	222
8.5	The benefits of trade and capital flows for living standards	228
8.6	The impact of trade tensions, protection and trade liberalisation	231
8.7	Trade liberalisation	234
8.8	Recent developments: a focus on Free Trade Agreements	238
8.9	The role of technological change and division of labour in international trade	240
8.10	Exchange rates	244
8.11	The effects of changes in the exchange rate on trade	247
8.12	Different perspectives on international trade and globalisation	248
8.13	Global responses to issues around trade	255
8.14	<i>Multiple choice review questions</i>	258
8.15	<i>Chapter crossword puzzle</i>	260
8.16	<i>Chapter summary</i>	262

**Chapter 9****Economics and environmental sustainability**

9.1	Introduction	264
9.2	Key environmental economic concepts	265
9.3	Climate change and global warming as environmental challenges	266
9.4	Economic factors influencing the extent of environmental challenges	271
9.5	Economic and policy responses to climate change	277
9.6	<i>Multiple choice review questions</i>	282
9.7	<i>Chapter crossword puzzle</i>	284
9.8	<i>Chapter summary</i>	285

**Chapter 10****Distribution of income and wealth**

10.1	What is income and wealth?	287
10.2	Measures of income and wealth distribution	294
10.3	The measurement of poverty	299
10.4	Income and wealth distribution in Australia over time	300
10.5	Recent trends in global income and wealth distribution and poverty	306
10.6	Why income and wealth distribution and poverty are important economic issues	317
10.7	Causes of income and wealth inequality and poverty in Australia	322
10.8	Causes of income and wealth inequality across the globe	331
10.9	Perspectives of economic agents on income and wealth inequality and poverty	338
10.10	Economic responses to address poverty and income and wealth inequality	342
10.11	Global efforts to reduce poverty and inequality	349
10.12	<i>Multiple choice review questions</i>	354
10.13	<i>Chapter crossword puzzle</i>	356
10.14	<i>Chapter summary</i>	358

**Valuable websites****360****Glossary of terms****361****Index of terms****379**

Visit [www.ecogroundup.com.au](http://www.ecogroundup.com.au) for multiple choice answers, sample responses to application exercises and crosswords, as well as additional support.