



UNIT 3 ECONOMICS

**SUM
MER**

SCHOOL

VCE SUMMER SCHOOL

Unit 3 Economics

Area of Study 1

An Introduction to Microeconomics:
The Market System, Resource
Allocation and Government Intervention

Area of Study 2

Domestic Macroeconomic Goals

Area of Study 3

Australia and the International Economy

VCE Accreditation Period
2023 – 2027



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VCE SUMMER SCHOOL HEAD START LECTURES

STUDY DESIGN (2023 – 2027) – EDITION 1

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ABOUT THE COVER IMAGE

THE POWER OF ART

Engaging with art is essential to the human experience. Almost as soon as motor skills are developed, children communicate through artistic expression. Throughout each stage of our lives, art plays different and important roles. The arts have the power to bring joy, stir up emotions and influence our behaviour. Art crosses all divides. It breaks down cultural, social and economic barriers and plays a big role in how humans see and interact with others, and the world in general.

Art decreases stress levels and improves mental health and well-being, particularly in patients suffering chronic or terminal illness. It has the power to educate people and convey meaning in a way that can be appreciated by every person. Furthermore, it gives us the opportunity to travel through time and learn from the beliefs, dreams, habits, thoughts, culture and lives of people in different places and times.

The arts also challenge us with different points of view, encourages communication, promotes stronger critical thinking and problem-solving skills and unlocks the potential of the human mind. It is also closely linked to academic achievement, civic engagement and social and emotional development.

The benefits of art are significant and undeniable. Use it to benefit both your mental and physical health as you journey through your VCE.



If you believe there is an error in this publication, please contact us as soon as possible (admin@tsfx.edu.au or 966 333 11). Amendments, errata, revisions, clarifications and further discussions will be published on our website at www.tsfx.edu.au/errata.

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**SECTION 1: UNIT 3 ECONOMICS
COURSE OUTLINE & ASSESSMENT
(2023 – 2027)**

VCE ECONOMICS STUDY DESIGN (2023 – 2027)

UNIT 3: AUSTRALIA'S LIVING STANDARDS

The Australian economy is constantly evolving. The main instrument for allocating resources is the market, but government also plays a significant role in resource allocation. In this unit students investigate the role of the market in allocating resources and examine the factors that affect the price and quantity traded for a range of goods and services. Students develop an understanding of the key measures of efficiency and how market systems might result in efficient outcomes. Students consider contemporary issues to explain the need for government intervention in markets and why markets might fail to maximise society's living standards. As part of a balanced examination, students also consider unintended consequences of government intervention in the market.

Students develop an understanding of the macroeconomy. They investigate the factors that affect the level of aggregate demand and aggregate supply in the economy and apply theories to explain how changes in these variables might affect achievement of domestic macroeconomic goals and living standards. Students assess the extent to which the Australian economy has achieved these macroeconomic goals during the past two years.

Australia's living standards depend, in part, on strong economic relationships with its major trading partners. Students investigate the importance of international economic relationships and the effect of these on Australian living standards. Students analyse how international transactions are recorded and examine how economic factors might affect the value of the exchange rate, the terms of trade and Australia's international competitiveness. Students also analyse how changes in the value of the exchange rate, the terms of trade and international competitiveness affect the domestic macroeconomic goals.

AREA OF STUDY 1: AN INTRODUCTION TO MICROECONOMICS: THE MARKET SYSTEM, RESOURCE ALLOCATION & GOVERNMENT INTERVENTION

In this area of study students investigate the role of the market in addressing the key economic questions of what and how much to produce, how to produce and for whom to produce. Students consider the effects of decisions made by consumers and businesses on what goods and services are produced, the quantities in which they are produced, the way they are produced and to whom they are distributed. Students investigate the key factors that affect the level of demand and supply in markets and how these might lead to changing prices, as well as the movement of land, labour and capital resources to those areas of production that generate the most value for society.

Students use models to make predictions and consider the role of markets in achieving economic efficiency. They discuss instances where the market fails to allocate resources efficiently and evaluate whether government intervention leads to a more efficient allocation of resources in terms of maximising society's living standards.

OUTCOME 1

On completion of this unit the student should be able to analyse how markets operate to allocate resources and evaluate the role of markets and government intervention in achieving efficient outcomes.

To achieve this outcome the student will draw on key knowledge and key skills outlined in Area of Study 1.

KEY KNOWLEDGE: OUTCOME 1

- The concept of relative scarcity, including needs, wants, resources, opportunity cost and the production possibility frontier (PPF) model, and the three basic economic questions.
- The meaning and significance of economic efficiency, including allocative efficiency, productive efficiency, dynamic efficiency and intertemporal efficiency and their relationship to the PPF model.
- The conditions for a free and perfectly competitive market.
- The law of demand and the theory of the law of demand, including the income effect and the substitution effect.
- The demand curve, including movements along and shifts of the demand curve.
- Non-price factors likely to affect demand and the position of the demand curve, including changes in disposable income, the prices of substitutes and complements, preferences and tastes, interest rates, population demographics and consumer confidence.
- The law of supply and the theory of the law of supply, including the profit motive.
- The supply curve, including movements along and shifts of the supply curve.
- Non-price factors likely to affect supply and the position of the supply curve, including changes in the costs of production, number of suppliers, technology, productivity, and climatic conditions.
- The effects of changes in supply and demand on equilibrium prices and quantity traded.
- The meaning and significance of price elasticity of demand and supply.
- Factors affecting price elasticity of demand, including degree of necessity, availability of substitutes, proportion of income and time.
- Factors affecting price elasticity of supply, including spare capacity, production period and durability of goods.
- The role of relative prices in the allocation of resources.
- The role of free and competitive markets in promoting an efficient allocation of resources and improved living standards.

- Types of market failure, including public goods, externalities, asymmetric information, and common access resources.
- The role and effect of indirect taxation, subsidies, regulations, advertising, and direct provision as forms of government intervention in the market to address market failure.
- One example of a government intervention in markets that unintentionally leads to a decrease in one of allocative, productive, dynamic, or intertemporal efficiency.

KEY SKILLS: OUTCOME 1

- Define key economic concepts and terms and use them appropriately.
- Construct and interpret demand and supply diagrams and a PPF model.
- Interpret and analyse statistical and graphical data.
- Gather, synthesise, and use economic data and information from a wide range of sources to analyse economic issues.
- Analyse how the forces of demand and supply effect equilibrium price and quantity traded.
- Analyse the responsiveness of the quantity demanded and the quantity supplied to changes in price.
- Evaluate the role of free and competitive markets in achieving an efficient allocation of resources.

AREA OF STUDY 2: DOMESTIC MACROECONOMIC GOALS

In this area of study students investigate Australia's domestic macroeconomic goals supporting living standards, including strong and sustainable economic growth, full employment and low and stable inflation (price stability). Using the five-sector circular flow model of the macroeconomy, students consider the role of key economic agents and examine the factors that affect the business cycle. Students examine how each of the goals is measured and the potential consequences associated with the level of achievement of each goal.

Students identify and analyse contemporary aggregate demand and aggregate supply factors that may have influenced the level of achievement of domestic macroeconomic goals over the past two years and consider how the level of achievement of the goals may affect living standards.

OUTCOME 2

On completion of this unit the student should be able to analyse key contemporary factors that may have affected domestic macroeconomic goals over the past two years, evaluate the extent to which the goals have been achieved and discuss the effects on living standards.

To achieve this outcome the student will draw on key knowledge and key skills outlined in Area of Study 2.

KEY KNOWLEDGE: OUTCOME 2

THE PURPOSE OF ECONOMIC ACTIVITY

- The difference between material and non-material living standards and factors that may affect living standards, including access to goods and services, environmental quality, physical and mental health, crime rates and literacy rates.
- The five-sector circular flow model of income, including the role of households, businesses, government, financial institutions, and the external sector in an open contemporary macroeconomy.
- The business cycle and its causes.
- The meaning and importance of aggregate demand and the factors that may affect the level of aggregate demand in the economy, including disposable income, interest rates, consumer confidence, business confidence, the exchange rate and rates of economic growth overseas.
- The meaning and importance of aggregate supply and the factors that may affect the level of aggregate supply in the economy, including quantity and quality of the factors of production, costs of production, technological change, productivity growth, exchange rates and climatic conditions, and other events including government regulations and disruptions to international supply chains.

THE DOMESTIC MACROECONOMIC GOALS

- The meaning of the goal of strong and sustainable economic growth.
- Measurement of the rate of economic growth using growth in real Gross Domestic Product (GDP).
- Consequences of not achieving the goal of strong and sustainable economic growth and its effect on living standards, including environmental degradation, external pressures, high inflation if growth is too high, and high unemployment if growth is too low.
- The meaning of the goal of full employment, including the NAIRU (natural rate of unemployment).
- Classifications within the labour force, including employed, unemployed, hidden unemployed, long-term unemployed, underemployed, and frictional unemployment.
- Measurement of the labour force, including the participation rate, the unemployment rate, and the labour force under-utilisation rate.
- The difference between cyclical and structural unemployment.
- The consequences of not achieving the goal of full employment and its effect on living standards, including the impact on GDP and tax revenue if unemployment is too high and the effects on inflation if unemployment is too low.
- The meaning of the goal of low and stable inflation (price stability).

- The distinction between inflation, disinflation, and deflation.
- Measurement of the inflation rate using the Consumer Price Index (CPI), including the difference between the headline, and underlying (core) rate of inflation.
- Causes of inflation, including demand inflation and cost inflation.
- Consequences of not achieving the goal of low and stable inflation (price stability) and its effect on living standards, including erosion of purchasing power, development of a wage-price spiral, distortion of spending and investment decisions, lower returns on investment, loss of international competitiveness if it is too high, and delayed consumption and unemployment if it is too low.
- Aggregate demand and aggregate supply factors that have affected the level of achievement or non- achievement of the goals of strong and sustainable economic growth, full employment and low and stable inflation over the past two years.

KEY SKILLS: OUTCOME 2

- Define key economic concepts and terms and use them appropriately.
- Calculate relevant economic indicators using real or hypothetical data.
- Construct, interpret and apply economic models including the five-sector circular flow model of income and the business cycle.
- Explain and interpret trends and patterns in economic data and other information gather, synthesise and use economic data and information from a wide range of sources to analyse economics issues.
- Apply economic concepts to analyse economic relationships and make predictions.
- Evaluate the extent to which the economy has achieved the domestic macroeconomic goals over the past two years and discuss the effect of this on living standards.

AREA OF STUDY 3: AUSTRALIA AND THE INTERNATIONAL ECONOMY

Australia is an open economy. Students examine the reasons for international trade, such as the exchange of goods and services and the movement of savings and investment capital, and how these transactions might affect living standards. Students describe how international transactions are recorded. Students analyse the effects of movements in the exchange rate, the terms of trade and changes in international competitiveness on the achievement of the domestic macroeconomic goals and living standards.

OUTCOME 3

On completion of this unit the student should be able to analyse the factors that may affect the exchange rate, terms of trade and Australia's international competitiveness, and discuss their impact on Australia's international transactions and the achievement of the domestic macroeconomic goals and living standards.

To achieve this outcome the student will draw on key knowledge and key skills outlined in Area of Study 3.

KEY KNOWLEDGE: OUTCOME 3

- The gains from international trade, including lower prices, greater choice, access to resources, economies of scale, and increased competition and efficiency.
- The balance of payments and its components.
- Cyclical and structural influences on Australia's current account balance.
- The composition and cause of net foreign debt and net foreign equities.
- The exchange rate, its meaning and measurement and the factors affecting its value, including relative interest rates, commodity prices and the terms of trade, demand for exports and imports, foreign investment, relative rates of inflation, credit ratings and speculation.
- The terms of trade, its meaning and measurement and the factors that may affect the terms of trade, including commodity prices and production costs in trading partners.
- International competitiveness and the factors that may affect international competitiveness, including productivity, production costs, availability of natural resources, exchange rates and relative rates of inflation.
- The effect of movements in the terms of trade and the exchange rate, and changes in international competitiveness on the domestic macroeconomic goals and living standards.

KEY SKILLS: OUTCOME 3

- Define key economic concepts and terms and use them appropriately.
- Explain key international economic relationships.
- Explain and interpret trends and patterns in economic data and other information
- Apply economic concepts to analyse economic relationships and make predictions.
- Calculate relevant international economic indicators using real or hypothetical data.
- Gather, synthesise, and use economic data and information from a wide range of sources to analyse and discuss economic issues.

UNIT 3 SCHOOL-BASED ASSESSMENT

**School Assessed Coursework for Unit 3 contributes
25% to your final study score.**

SATISFACTORY COMPLETION

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 to provide a range of opportunities for students to demonstrate the key knowledge and key skills in the outcomes.

ASSESSMENT OF LEVELS OF ACHIEVEMENT

The student's level of achievement in Unit 3 will be determined by School-assessed Coursework. School-assessed Coursework tasks must be a part of the regular teaching and learning program and must not unduly add to the workload associated with that program. They must be completed mainly in class and within a limited timeframe.

Teachers will provide to the VCAA a numerical score representing an assessment of the student's level of achievement. The score must be based on the teacher's assessment of the performance of each student on the tasks set out in the following table.

CONTRIBUTION TO FINAL ASSESSMENT

School-assessed Coursework for Unit 3 will contribute 25 per cent to the study score.

It is required that a minimum of two different assessment task types will be used to assess School-assessed Coursework in Unit 3.

UNIT 3 ASSESSMENT TASKS

Outcomes	Marks Allocated	Assessment Tasks
<p>Outcome 1</p> <p>Analyse how markets operate to allocate resources and evaluate the role of markets and government intervention in achieving efficient outcomes.</p>	35	<p>The student's performance will be assessed using two or more of the following:</p> <ul style="list-style-type: none"> • a folio of applied economics exercises • an extended response
<p>Outcome 2</p> <p>Analyse key contemporary factors that may have affected domestic macroeconomic goals over the past two years, evaluate the extent to which the goals have been achieved and discuss the effects on living standards.</p>	40	<ul style="list-style-type: none"> • an essay • a report • a data analysis • a media analysis • a case study • structured questions.
<p>Outcome 3</p> <p>Analyse the factors that may affect the exchange rate, terms of trade and Australia's international competitiveness, and discuss their impact on Australia's international transactions and the achievement of the domestic macroeconomic goals and living standards.</p>	25	
Total Marks		100

EXTERNAL ASSESSMENT

The level of achievement for units 3 and 4 is also assessed by an end-of-year examination, which will contribute 50 per cent to the study score.

The full study design is available on the VCAA website:

<http://www.vcaa.vic.edu.au/vce/studies/economics/economicsindex.html>

For past examination papers and examiner's reports go to:

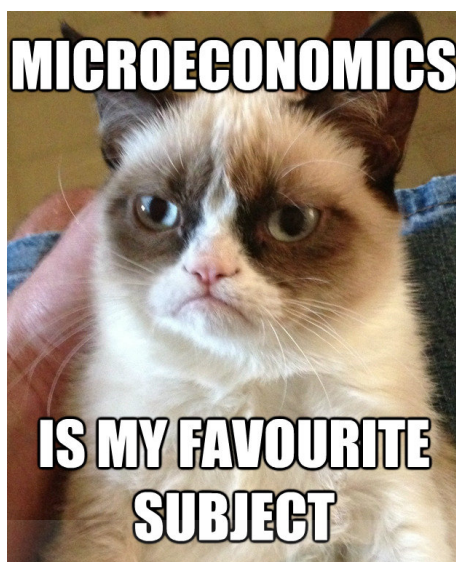
<http://www.vcaa.vic.edu.au/vce/studies/economics/exams.html>

SECTION 2: AREA OF STUDY 1

AN INTRODUCTION TO MICROECONOMICS: THE MARKET SYSTEM, RESOURCE ALLOCATION & GOVERNMENT INTERVENTION

AREA OF STUDY 1

AN INTRODUCTION TO MICROECONOMICS: THE MARKET SYSTEM, RESOURCE ALLOCATION & GOVERNMENT INTERVENTION



Source: <http://www.quickmeme.com/img/71/718ca16323d776f8f116b13fc4d73dead33ea48cc84ad287aa6aade5572ae489.jpg>

Economics is a study of choice and how to improve living standards. It examines the way in which decisions are made about how scarce resources are used to produce goods and services and, how these goods and services are then distributed between individuals in order to satisfy their needs and wants and improve their living standards.

AREA OF STUDY 1: AN INTRODUCTION TO MICROECONOMICS: THE MARKET SYSTEM, RESOURCE ALLOCATION & GOVERNMENT INTERVENTION

In this area of study students investigate the role of the market in addressing the key economic questions of what and how much to produce, how to produce and for whom to produce. Students consider the effects of decisions made by consumers and businesses on what goods and services are produced, the quantities in which they are produced, the way they are produced and to whom they are distributed. Students investigate the key factors that affect the level of demand and supply in markets and how these might lead to changing prices, as well as the movement of land, labour and capital resources to those areas of production that generate the most value for society.

Students use models to make predictions and consider the role of markets in achieving economic efficiency. They discuss instances where the market fails to allocate resources efficiently and evaluate whether government intervention leads to a more efficient allocation of resources in terms of maximising society's living standards.

OUTCOME 1

On completion of this unit the student should be able to analyse how markets operate to allocate resources and evaluate the role of markets and government intervention in achieving efficient outcomes.

To achieve this outcome the student will draw on key knowledge and key skills outlined in Area of Study 1.

KEY KNOWLEDGE: OUTCOME 1

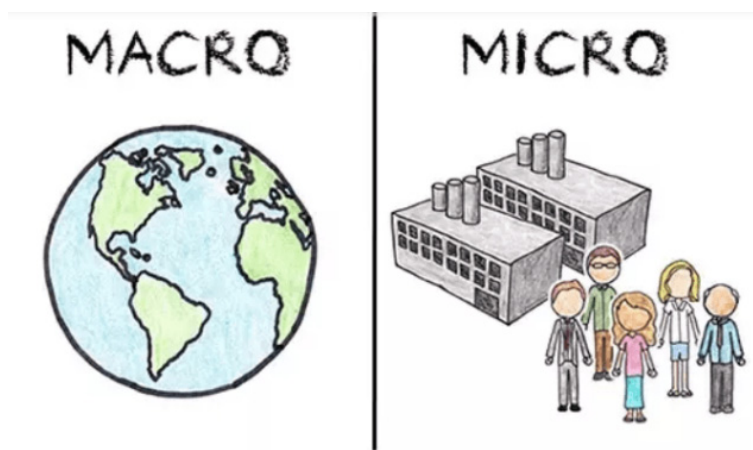
- The concept of relative scarcity, including needs, wants, resources, opportunity cost and the production possibility frontier (PPF) model, and the three basic economic questions.
- The meaning and significance of economic efficiency, including allocative efficiency, productive efficiency, dynamic efficiency and intertemporal efficiency and their relationship to the PPF model.
- The conditions for a free and perfectly competitive market.
- The law of demand and the theory of the law of demand, including the income effect and the substitution effect.
- The demand curve, including movements along and shifts of the demand curve.
- Non-price factors likely to affect demand and the position of the demand curve, including changes in disposable income, the prices of substitutes and complements, preferences and tastes, interest rates, population demographics and consumer confidence.
- The law of supply and the theory of the law of supply, including the profit motive.
- The supply curve, including movements along and shifts of the supply curve.
- Non-price factors likely to affect supply and the position of the supply curve, including changes in the costs of production, number of suppliers, technology, productivity, and climatic conditions.
- The effects of changes in supply and demand on equilibrium prices and quantity traded.
- The meaning and significance of price elasticity of demand and supply.
- Factors affecting price elasticity of demand, including degree of necessity, availability of substitutes, proportion of income and time.
- Factors affecting price elasticity of supply, including spare capacity, production period and durability of goods.
- The role of relative prices in the allocation of resources.

- The role of free and competitive markets in promoting an efficient allocation of resources and improved living standards.
- Types of market failure, including public goods, externalities, asymmetric information, and common access resources.
- The role and effect of indirect taxation, subsidies, regulations, advertising, and direct provision as forms of government intervention in the market to address market failure.
- One example of a government intervention in markets that unintentionally leads to a decrease in one of allocative, productive, dynamic, or intertemporal efficiency.

KEY SKILLS: OUTCOME 1

- Define key economic concepts and terms and use them appropriately.
- Construct and interpret demand and supply diagrams and a PPF model.
- Interpret and analyse statistical and graphical data.
- Gather, synthesise, and use economic data and information from a wide range of sources to analyse economic issues.
- Analyse how the forces of demand and supply effect equilibrium price and quantity traded.
- Analyse the responsiveness of the quantity demanded and the quantity supplied to changes in price.
- Evaluate the role of free and competitive markets in achieving an efficient allocation of resources.

MACROECONOMICS AND MICROECONOMICS



- **Macroeconomics** is the study of the whole economy and focuses on the central role played by aggregate demand as well as aggregate levels of production, expenditure, income and employment.
 - Aggregate indicators include gross domestic product (GDP), aggregate demand, the inflation rate, the unemployment rate.
 - Macroeconomic policies include budgetary policy and monetary policy.
- **Microeconomics** is the study of the operation of small sectors or parts of the economy and individual markets within the economy such as:
 - Particular firms and industries.
 - Consumer/household behaviour.
 - The labour markets.
 - The markets for particular goods and services (e.g. housing market).
 - Microeconomics focuses on the supply side of the economy.
 - Microeconomic policy focuses on reforming the economy to make it more efficient. Such policies include Labour Market Reform and Trade Liberalisation.

INTRODUCTORY CONCEPTS

1. RELATIVE SCARCITY

- **Needs** are goods and services necessary for survival. E.g. food, clothing, shelter.
- **Wants** are items that make life enjoyable. E.g. magazines, iPods, cars.
- People's **needs and wants** are assumed to be **unlimited**.
- **Resources** are insufficient to satisfy people's needs and wants, i.e. they are **limited or scarce**.
- **Relative scarcity** arises because of unlimited needs and wants *in relation to* limited productive resources. Relative scarcity is the fundamental **economic problem** that must be addressed by all societies.

2. RESOURCES

- Resources (Factors of Production) are productive inputs used by businesses to produce goods and services.
- The three main types of resources required for production are:
 - **Natural Resources**

All naturally occurring resources used in the production process. They are provided by nature, e.g. land, trees, water, minerals, farm animals.
 - **Labour**

Physical and mental effort used in the process of production e.g. physical skills of a builder or mental effort of a lawyer. This category includes the skills involved in managing a business.
 - **Entrepreneurship**

Which is a subset of the labour resource.
 - **Capital**

Resources made by humans which are used in the production process to help make other goods and services i.e. physical plant such as factories and offices, and equipment such as machinery, tools, vehicles, computers. When firms increase their stock of capital equipment, it is called **investment**.

Production refers to the process where these resources are combined to create goods and services. i.e. making goods and services.

The availability (quantity) and quality of resources as well as how efficiently they are used will determine a country's **productive capacity** – the economy's physical limit or potential to produce goods and services.

3. AN EFFICIENT ALLOCATION OF RESOURCES

The allocation of resources refers to how the resources of natural resources, labour and capital are used to produce goods and services in the economy. When resources are used to produce one type of good or service then they cannot be used for the production of another good or service (there is an opportunity cost).

The most efficient allocation of resources will occur where the *maximum amount of satisfaction is obtained by society at the lowest opportunity cost. Scarce resources are used in a way that maximises production. When resources are allocated efficiently, it is not possible to increase national production (GDP) further by changing the way resources are used.*

There are **four types of efficiency** that an economy aims to achieve:

- **Allocative efficiency** is achieved when the goods and services that people want the most will be produced in the best possible way so that it is able to maximise the needs and wants of society.
- **Productive (or technical) efficiency** is achieved when the least cost method of production occurs – output is maximised whilst average costs are at a minimum.
- **Dynamic efficiency** refers to how quickly an economy can reallocate resources to achieve allocative efficiency.
- **Inter-temporal efficiency** is achieved when there is a need to balance current and future consumption.

4. OPPORTUNITY COST



Opportunity cost arises out of the choices made by individuals and nations because when a decision is made to use scarce resources to produce particular goods or services, those resources are not available to produce other goods or services.

Opportunity cost is the value of the next best alternative use which is foregone (lost) when a decision is made to direct resources to another use. For example:

- The opportunity cost of your coming to this lecture may be going to the beach with your friends (assuming this is the next best alternative use of your time).
- The opportunity cost of a family purchasing a new car may be a holiday they gave up (if this is the next best alternative use of their money).
- The opportunity cost of using land for a supermarket may be the loss of a public swimming pool (if this is the next best alternative use of the land).

To maximise the satisfaction of our needs and wants, we must allocate resources in the most efficient way possible. This essentially means that we will want to use resources in a way that will minimise opportunity cost.

An Example:

A government debt mountain?

In the long run, a high level of government borrowing adds to the accumulated National Debt. This means that the Government has to spend more each year in debt-interest payments to holders of government bonds and other securities. There is an **opportunity cost** involved here because interest payments might be used in more productive ways, for example an increase in spending on health services or education.

Source: *tutor2u.net/economics*



OR

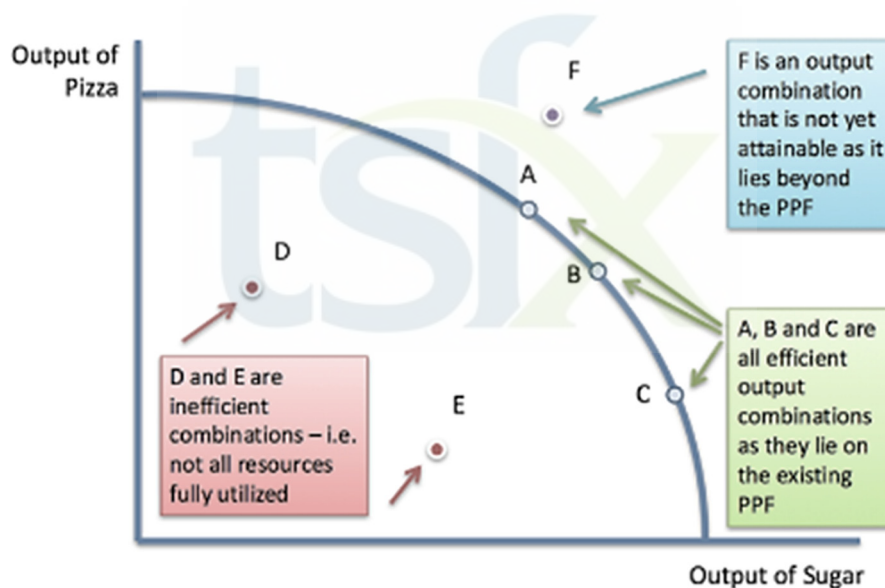


5. PRODUCTION POSSIBILITY FRONTIER

A production possibility frontier illustrates the combination of goods and services which can be produced by a nation using all of the available resources.

Whenever a combination of goods/services is produced using the available resources, it follows that another combination will not, hence be creating an opportunity cost.

- The production possibility frontier (PPF) illustrates how an economy could allocate its scarce resources and hence depicts the productive capacity of an economy producing two types of output – for example, goods and services.
- The economy can produce on or below the PPF but not outside it at the present time (as all scarce resources have currently been exhausted).
- Various points along the PPF represent the many possible production options, all of which involve an opportunity cost or a trade-off, as increasing the production of one product, it will reduce the ability to produce the same quantity of an alternative product.
- The choice which maximises the value of goods and services produced will also maximise satisfaction and minimise opportunity cost.



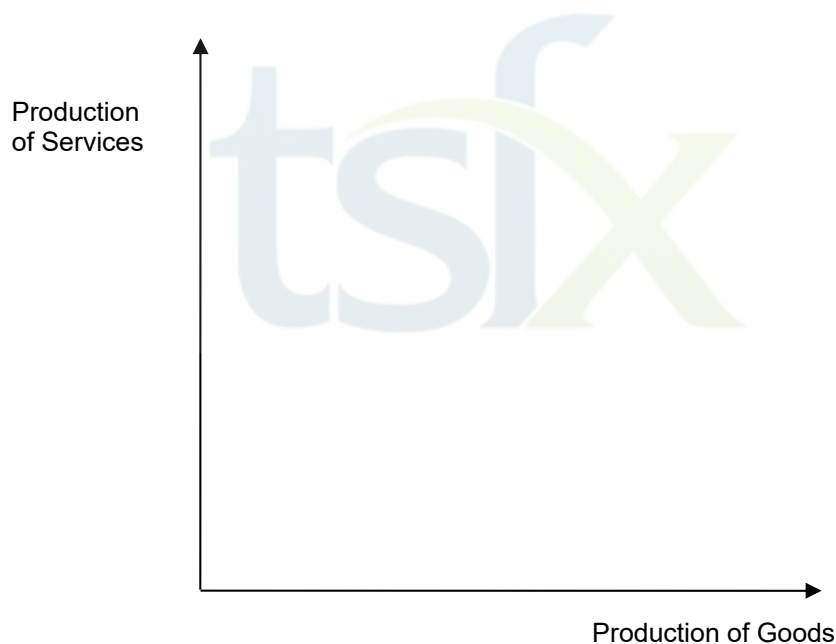
QUESTION 1

Examine the table above and calculate the Total Value of Combinations. Which production combination is the most efficient? Why?

QUESTION 2

Plot the figures in the table below on the diagram to create a PPF.

Production Combination	Production Possibility Combinations		Total Value of Combinations
	Production of Goods Units per year	Production of Services Units per year	
A	10.0	0.0	
B	9.8	0.5	
C	9.4	1.0	
D	8.8	1.5	
E	8.0	2.0	
F	7.0	2.5	
G	5.8	3.0	
H	4.4	3.5	
I	0.0	4.0	



The aim of any economy is to extend its production possibility curve so that as many of societies needs and wants as possible can be satisfied. This can be achieved if we are able to increase the quantity of resources available for the production of goods and services or if the existing scarce resources (natural, labour, capital) are used more efficiently.

The following may help to increase a country's productive capacity:

- The use of the latest technology or more efficient production methods.
- Immigration.
- A more highly skilled labour force.
- Exploration and discovery of new natural resources.

QUESTION 3

Draw a new PPF on the previous diagram to illustrate the effect of one of the above scenarios.

QUESTION 4

If the economy is operating inside the PPF what does this indicate about the allocation of resources?

QUESTION 5

How can a country reach a point outside its production possibility frontier?

THE THREE BASIC ECONOMIC QUESTIONS

Due to the basic economic problem of **relative scarcity**, it is not possible to satisfy everyone's needs and wants so **choices** must be made regarding the best use of scarce resources.

To make these choices, all economic systems must answer three basic economic questions:

1. What to produce?

Decisions must be made about what types of goods and services are produced and how many to produce.

2. How to produce?

Decisions must be made about what combination of natural resources, labour and capital are used in the production process and what method of production will be used. E.g. Labour-intensive or capital intensive. Producers will aim to use the least cost method of production.

3. For whom to produce?

Decisions must be made about who receives the goods and services produced. Questions must be answered about how the goods and services will be distributed amongst society.

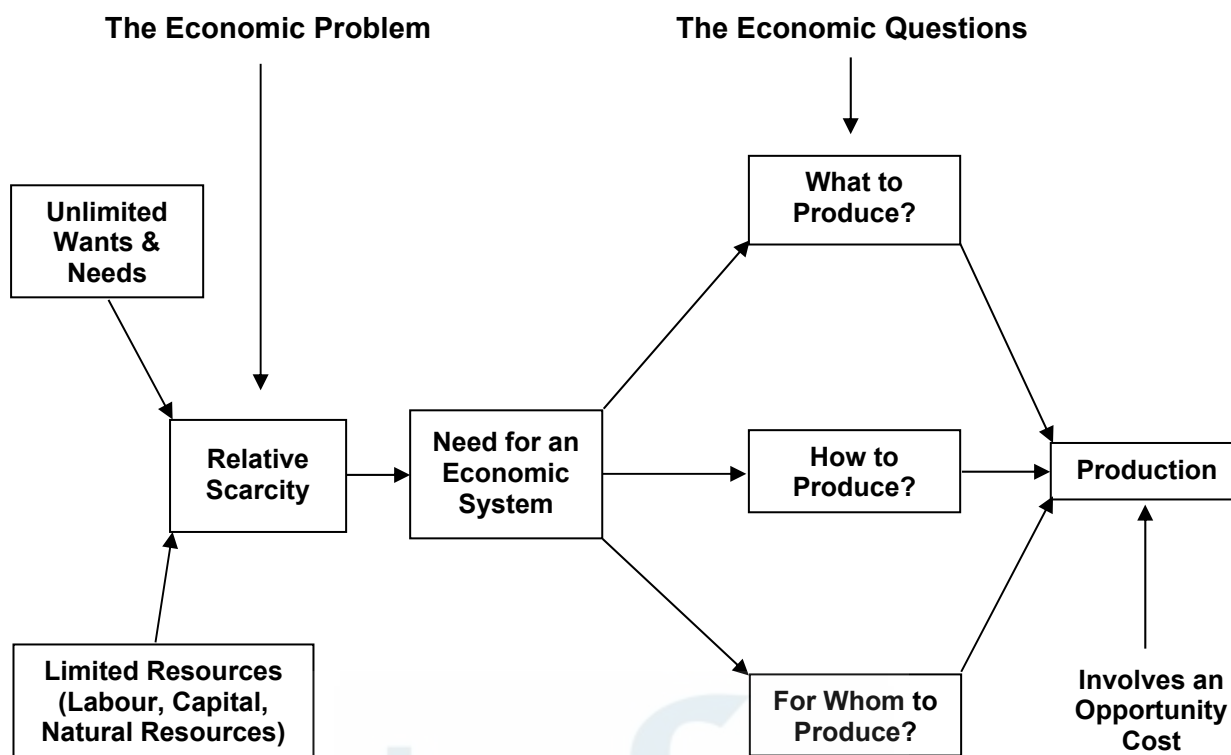
E.g. Will it depend on an individual's income or will there be provision by the government for those who have insufficient income to provide for themselves?

Australia has a predominately **MARKET ECONOMY** – it relies heavily on the operation of the free market to answer these questions. Around 80% of resources are allocated by the market and the remaining 20% are allocated through government intervention.

QUESTION 6

How does Australia answer each of these three fundamental economic questions?

THE ECONOMIC PROBLEM – CONCEPT MAP



QUESTION 7

Chris can bake 8 pies and 4 loaves of bread per hour. For Chris, the opportunity cost of baking an extra pie is:

- A $\frac{1}{2}$ a loaf of bread
 - B $\frac{1}{2}$ pie
 - C 2 loaves of bread
 - D 2 pies
-
-

QUESTION 8

What is meant by the statement that every economic system faces the problem of economic scarcity?

- A There are times when some products can be purchased only by paying high prices.
 - B Shortages occur due to production bottlenecks.
 - C There are insufficient resources to satisfy all wants of society.
 - D Economic systems have cyclically recurring recessions during which scarcities occur.
-
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QUESTION 9

At a particular point in time, the quantity of resources available for national production is:

- A Fixed.
 - B Infinite.
 - C Sufficient to meet the wants of society.
 - D Mostly made available free of charge.
-
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QUESTION 10

Which of the following statements is most correct when all of a nation's resources are fully and most efficiently employed?

- A Scarcity no longer exists.
 - B It is generally possible to raise GDP quickly.
 - C It is generally not possible to increase the total value of production in the short term by reallocating resources.
 - D The economy is not necessarily at its productive capacity.
-
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QUESTION 11 (VCAA EXAMINATION 2010)

Which of the following statements provides the best definition of an efficient allocation of resources?

- A The opportunity cost of the allocation of resources is zero.
 - B Resources are allocated so that productivity is rising at the maximum possible rate.
 - C There is no alternative allocation of resources which will yield greater satisfaction to society.
 - D Resources are allocated so that maximum output is obtained from the available factors of production.
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QUESTION 12 (VCAA EXAMINATION 2016)

When resources are used to produce the goods and services that best satisfy society's needs and wants, this is known as?

- A Dynamic efficiency.
 - B Allocative efficiency.
 - C Intertemporal efficiency
 - D Productive or technical efficiency.
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