



## GENERAL COMMENTS

Over the past three years assessors have reported that students' achievement on the Economics examination has continued to improve, with students this year performing particularly strongly in Section A, the multiple-choice section. The introduction of an answer booklet for Section B had a positive impact as it assisted students in time management. The answer booklet provided a guide to the required length of each answer and meant that the majority of students attempted all parts of all questions, with more finishing the examination than in previous years. This resulted in better student outcomes.

There was evidence of improved understanding of some key economic knowledge, such as the nature and operation of monetary policy and its relationship to budgetary policy. This resulted in particularly sound answers in Section B, Question 2. However, there were still aspects of key knowledge that students found challenging, and more work needs to be done in understanding the distinction between production and productivity and in understanding the factors that increase Australia's productive capacity and how this contributes to stronger economic growth. Students also need to develop their knowledge of external stability and equity in the distribution of personal income, and improve their understanding of key economic relationships, such as relationships between production, productivity, equity and the standard of living.

It was pleasing to see that a number of students used their understanding of current economic issues and conditions in response to questions in Section B. Generally, students who were aware of and understood current economic issues and conditions performed better in the examination. Students who understand current factors that are affecting the performance of the Australian economy and who keep up to date with how policies are being used can include references to these in their answers as well as provide examples to illustrate their explanations. They can also respond quickly and more confidently to questions which link to current economic issues in the economy such as in Section B, Questions 1a and e, Questions 2a–e, and Question 3c.

Generally, students recognised the requirements of the instructional verbs in the questions in Section B, especially when asked to outline or explain. However, students were more challenged when asked to evaluate or examine. Use of instructional verbs such as these in school-based assessment tasks could assist students to develop their understanding and ability to respond appropriately in the examination.

## Section A – Multiple-choice questions

This table indicates the number of students who chose each option. The correct answer is indicated by shading.

Question	A %	B %	C %	D %
1	5	4	4	87
2	3	8	7	83
3	7	7	81	5
4	3	88	1	8
5	66	14	5	15
6	8	70	16	6
7	55	10	12	22
8	13	79	2	6
9	81	4	13	3
10	3	7	80	10
11	11	12	8	69
12	8	4	62	27
13	22	11	54	12
14	7	9	9	75
15	88	6	1	5



## Section B – Written responses

Note: Student responses reproduced herein have not been corrected for grammar, spelling or factual information.

### Question 1a

Marks	0	1	2	Average
%	11	33	57	1.5

While many students gave excellent definitions of unemployment, many students surprisingly suggested that the government was aiming for unemployment at around seven per cent without challenging this view, even though unemployment was much lower than this at the time of the examination. This is an example of where students need to keep as up-to-date as possible about current economic conditions in order to enhance their knowledge and understanding. The best answers gave a clear definition such as:

- full employment occurs when nearly all available resources are fully utilised. In respect to labour, full employment is considered to be achieved when nearly all persons willing and able to work at the prevailing wage rate and working conditions are able to find employment

or

- full employment is one of the Federal Government's economic objectives. This objective relates to a situation where cyclical unemployment associated with weak expenditure and recession is avoided but where a fairly low level of natural unemployment (for example, frictional) is tolerated.

Following on from the definition, better answers generally talked about an acceptable 'zone' of unemployment and how the current rate of unemployment fitted with this. Poorer answers either had a confused or incomplete definition of unemployment and/or referred to the types of unemployment, which was not a requirement of the question.

### Question 1b

One of the examination criteria required students to demonstrate an understanding of the relationships and inter-relationships between economic objectives. This question asked students to explain the relationship between two economic objectives. In a question such as this, students should not simply state or describe a relationship without explaining economic reasons for the relationship.

#### 1bi.

Marks	0	1	2	Average
%	26	20	54	1.3

When describing the relationship between full employment and price stability, many students seemed to be under the impression that whenever there is an increase in demand there will always be an increase in prices. Students did not recognise the importance of the degree of spare capacity in the economy. The best answers explained the incompatibility of the relationship in terms of the economy reaching productive capacity and demand inflation being the result. An example of such an answer stated:

*Full employment occurs when nearly all available resources are fully utilised. Therefore, when a stimulus occurs to demand, such as that caused by a reduction in income tax or in interest rates which stimulates spending, then it is difficult for supply to be adjusted up as the economy is operating close to productive capacity. Therefore it may not be able to meet the new higher levels of demand and so upward pressure is put on prices ( $D > S$ ). So in times of full employment it is likely that there would be demand pressures triggered thus leading to a possible rise in demand inflation therefore causing some price instability.*

#### 1bii.

Marks	0	1	2	Average
%	16	28	56	1.4

The second part of the question asked students to explain the relationship between full employment and equity in personal income distribution. The best answers briefly defined equity and explained how full employment affects the distribution; however, many students failed to provide sufficient detail about the relationship to score full marks. Most students knew that having a job provides an income but were then unable to explain how this impacts on equity in personal income distribution. There were some concerns expressed by assessors that many students had not developed sufficient detailed knowledge about the meaning of equity in personal income distribution. The following sample answer demonstrates the sort of explanation that was required.

*In times of full employment, this means that virtually all persons who are willing and able to work have a job. Therefore, this is likely to have a positive impact on equity in personal income distribution as this means the number of citizens dependent on unemployment benefits is much reduced. With fewer citizens dependent on government transfer payments and welfare, it is likely that equity in personal income distribution is somewhat improved. This is because when there is a rise in numbers dependent on transfers in times of unemployment, there are larger gaps between those earning an income and those on unemployment benefits which leads to higher levels of inequity.*

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## Question 1c

Marks	0	1	2	3	4	Average
%	11	15	24	23	27	2.4

The best answers included a brief definition of sustainable economic growth and selected two factors that influenced the achievement of this growth. Good answers distinguished between the ways that demand factors and supply factors cause growth. Poorer students seemed unable to select a factor and often wrote about how the factor may influence unemployment or inflation but not how the factor influenced the achievement of a sustained rise in economic growth. It also often seemed that students were able to explain how demand factors influence growth but were less able to explain how supply factors influence productive capacity and how this then influences economic growth.

## Question 1d

Marks	0	1	2	3	4	Average
%	30	13	29	14	14	1.7

Students found it difficult to select two reasons why there has only been a gradual reduction in unemployment even though Australia has experienced economic expansion since the early nineties. The best answers included a discussion of issues such as structural and technological change, increasing participation rates and the role of microeconomic reform in increasing efficiency and productivity.

## Question 1ei.

Marks	0	1	2	3	4	Average
%	13	20	24	24	20	2.2

## 1eii.

Marks	0	1	2	3	4	Average
%	11	15	25	25	23	2.4

This question required students to recognise the links between factors affecting economic growth and the implications these then had for the standard of living. Australia's ageing population and its implications for future living standards has been a topic widely discussed in the media and in government publications (such as the budget papers) over the past few years. There has also been wide coverage of the role of rising productivity in assisting the achievement of sustained economic growth. However, students generally found both parts of this question challenging. Most students were able to explain some economic implications for the labour force of an ageing population, but many had difficulty actually explaining what these implications may mean for Australia's future living standards. Students also struggled to explain the link between rising productivity and the standard of living.

While there were some excellent answers provided, some answers indicated confused thinking. For example, some students thought that a decrease in the size of the labour force would lead to a rise in unemployment, when initially the reverse would occur. Other students suggested that due to the decreasing size of the labour force there would be decreased productivity. Quite possibly these students meant to say a decrease in production, but again this highlighted a lack of understanding about the differences between production and productivity.

In spite of these issues, many good points were made by students, such as the reduced incomes of retirees (who no longer have access to wages and salaries) reducing their access to goods and services, thus decreasing their living standards and the subsequent need for the government to pay an increasing amount on pensions, aged care and health. This will impact on the ability of governments to provide other services such as education and infrastructure, and may result in the need to raise taxes, therefore placing a greater burden on wage-earners and possibly impacting negatively on their living standards.

## Question 2a

Marks	0	1	2	3	4	Average
%	18	17	26	19	21	2.1

A good knowledge of recent economic conditions assisted students in answering this question. The best answers explained how interest rate differentials in the Australian and American economies (there were relatively higher rates in Australia) meant that there was stronger demand for the Australian dollar. Others referred to specific factors that affected the increased credit transactions relative to debit transactions in the balance of payments. There were, however, still a large number of students who confused the meaning of the terms trade and trade weighted index (TWI) and used these terms in an incorrect context.

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## Question 2b

Marks	0	1	2	Average
%	33	23	43	1.1

This question seemed to cause unnecessary confusion. Many students wrote about the way the Reserve Bank of Australia (RBA) operates monetary policy rather than answering the question. For two marks, students were required to outline the current operational objective of Australian monetary policy, which is: in pursuing the medium-term goal of price stability, the Reserve Bank of Australia has adopted the objective of keeping inflation, as measured by the Consumer Price Index (CPI), between two and three percent per annum on average over the business cycle.

## Question 2c

Marks	0	1	2	Average
%	53	15	32	0.8

This was a very poorly answered question. Many students were unable to explain the direct effects of the appreciation of the Australian dollar on import prices. This highlights the need for student answers to focus on the direct and most obvious explanations and relationships rather than drawing on less significant points which require more explanation. The best answers explained that an appreciation of the Australian dollar means the value of the Australian dollar has gone up, thus making exports relatively more expensive and imports relatively cheaper. If imports are cheaper, then this has a positive impact on price changes, thus reducing any imported inflation tendencies and improving price stability outcomes.

## Question 2d

Marks	0	1	2	Average
%	39	11	50	1.1

It was very pleasing that the majority of students recognised that a tightening in monetary policy means that interest rates go up. However, many students were unable to explain how this might impact on the value of the Australian dollar, even though in Question 2a a number of them were able to explain that interest rate differentials were a cause of appreciation of the Australian dollar. Students appeared less sure about explaining relationships about the impact of policy changes on the external sector than they were about how policy changes affect the domestic economy.

## Question 2ei.

Marks	0	1	2	Average
%	27	24	49	1.2

Too many students didn't know the meaning of external stability. It was also a concern that many students seemed to think that the Australian Government is responsible for all of Australia's net foreign debt. Good answers referred to either the impact on imports or the need to borrow externally should the budget go into deficit.

## 2eii.

Marks	0	1	2	Average
%	27	31	41	1.2

Students appeared to lack an understanding of income distribution. Many students suggested that a decrease in taxes would increase income but did not go on to outline how this impacted on personal income distribution. Also, many students simply concluded that lower taxes and higher incomes would be positive for personal income distribution without saying why. Better answers usually took an actual example to illustrate an effect, such as the following answer: *If the government cuts income taxes by reducing marginal income tax rates, then the progressive nature of this tax is compromised which would lead to less equal personal income distribution. The tax cut in the 2004-05 budget being limited to those earning more than \$1000.00 per week makes personal income distribution more unequal.*

## 2eiii.

Marks	0	1	2	3	4	Average
%	17	11	14	24	33	2.5

The responses to this question were generally very pleasing. The majority of students understood the scenario that was presented and were able to explain how the changes in budgetary policy would most likely impact on price stability, and how this may then impact on monetary policy settings.

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## Question 3a

Marks	0	1	2	Average
%	19	22	58	1.4

The majority of students were able to provide a rationale for microeconomic reform policies. Many excellent answers were provided, such as:

*Microeconomic reform policy, such as labour market reform or national competition policy, which responds to and causes change in the structure of the economy, is aimed at increasing the economy's longer-run rate of economic growth by increasing the rate of expansion in its productive capacity (ie. by shifting the aggregate supply curve to the right). It also aims to make the economy more flexible in response to shocks, so that it generates less inflation or unemployment than it did.*

## Question 3b

Marks	0	1	2	3	4	5	6	Average
%	17	8	10	13	20	19	13	3.2

After a strong start in Question 3a, it was very disappointing to note that many students were unable to give any examples of microeconomic reform policies. This is of concern as this is an important part of the key knowledge in Area of Study 2 in Unit 4. There was also a large number of students who, after giving two appropriate examples, were unable to provide sufficient depth in their discussion to achieve top marks for the question. These students were often able to describe the characteristics of the policies selected (the nature) but were unable to discuss how the policies worked to improve productive capacity and increase efficiency in order to secure stronger economic growth (their operation).

## Question 3c

Marks	0	1	2	3	4	Average
%	9	11	18	25	37	2.7

This question was very topical and most students had something of relevance to say in their answer. Possible benefits included that:

- the proposed AUSFTA is an extension of trade liberalisation, which is about improving welfare by encouraging nations to take advantage of their competitive advantage. The idea is that enhanced trade opportunities encourage Australia to produce more of what can be produced most efficiently (such as iron ore, beef, wine and some bio-tech products) and to buy cheaply from the US what cannot be produced as efficiently (such as aeroplanes and software)
- Australia has agreed to give preferential access to most US manufacturing and farm exports. This should in itself be positive for economic growth because it will encourage Australian producers to leave sectors where the US is more efficient and to take up more productive units.

Possible costs included that:

- the proposal is disadvantageous because the US has not agreed to eliminate trade barriers to Australian exports that matter the most (such as sugar, dairy and beef)
- it is disadvantageous because it encourages Australia to buy American products even when other countries can produce them more cheaply. Some economists believe it will do more to 'divert' trade from the rest of the world than to 'create' trade
- agreeing to a deal without significant gains in agriculture has weakened Australia's ability to ask other countries to lower their farm barriers, either in country-to-country bilateral talks or in multilateral forums such as the WTO.

## Question 3d

Marks	0	1	2	3	4	5	6	7	8	Average
%	26	12	12	13	13	10	8	4	2	2.7

This was essentially a question about Australia's policy mix and it was expected that students would be able to write about how microeconomic reform has built productive capacity, while macroeconomic policies have played a demand management role.

Students generally performed very poorly on this question. While the majority of students attempted the question, few had planned a response or left adequate time for the question. Students are advised to plan their answers, especially those which are worth eight or ten marks and require longer responses that include a number of points. It was clear that a large number of students did not understand what the question required and it seemed that some students rushed to write all they knew about macroeconomic and microeconomic reform (MER) policy but did not take the time to think



about what the question was asking of them. Many students failed to notice that they needed to evaluate how macroeconomic policy has supported microeconomic policy over the past ten years.

It is important for students to appreciate that a question worth eight marks gives them a chance to interpret the question, describe the context and/or use definitions in order to frame their answer. In answer to this question, the best students explained in their introduction why Australia has been considered to be one of the best performers in the OECD over the past decade by discussing the length of the Australia's economic expansion, the relatively strong levels of growth, the relatively low levels of inflation and the gradual reduction in unemployment. Good answers explained the meaning of macroeconomic and MER policies and explained how MER policies influence Australia's positive economic outcomes, in particular focusing on Australia's improved productivity record over the past decade. Once these points had been made, students were able to talk about how macroeconomic policy had complemented or conflicted with MER in achieving these positive outcomes. For example, some very strong answers discussed the importance of inflation targeting by the RBA, which has seen the maintenance of relatively low interest rates over the past decade (macroeconomic policy) which has in turn helped microeconomic policy to achieve positive economic outcomes.

The following is a sample answer that was judged to be of a very high standard.

*The length and strength of Australia's expansion phase since the early 1990s is the result of sound macroeconomic management and the increased efficiency and productivity resulting from the implementation of a range of microeconomic reforms. Therefore, macroeconomic policy has supported microeconomic policy in the achievement of relatively strong, non-inflationary growth.*

*Microeconomic reform policy, such as national competition policy, is aimed at increasing the economy's longer-run rate of economic growth by increasing the rate of expansion in its productive capacity. The idea is to raise the economy's supply potential through the more efficient allocation of resources. This means that economic growth rates can be lifted without triggering the demand pressures that once caused inflation, which became a 'speed limit' to growth.*

*Macroeconomic management through Budgetary/Fiscal policy and Monetary policy involves the management of demand in a way that moderates the fluctuations in demand as the economy moves through the business cycle. By moving their policy instruments in a 'counter cyclical' fashion (such as taxation in the case of fiscal policy and interest rates in the case of monetary policy), the macro managers seek to stabilise the economy by cutting off the peaks and filling in the troughs. In the process, they should limit the acceleration in inflation when demand is growing too strongly and limit the rise in unemployment when demand is growing too weakly. So macro management is about managing demand and therefore domestic economic stability. For example, when demand pressures seem to be building and there appears to be a likely threat to the Reserve Bank's inflation target, the Reserve Bank acts pre-emptively by raising interest rates to curb demand pressures. It is believed that the medium term strategies adopted for fiscal and monetary policies in recent years, has meant that the economy has been managed more successfully so that the severe peaks and troughs in economic activity have been avoided.*

*It is believed that microeconomic policies have been able to create a faster rate of growth through improvements in productivity, efficiency and competitiveness. More competitive markets, more efficient enterprises and a more productive workforce combine to reduce unit production costs. This places downward pressure on inflation and inflationary expectations. Firms find it more difficult to raise prices in such a climate. Over the long run, profits and wages may both rise, along with economic growth and employment opportunities. This appears to be what has happened in the Australian economy since the early 1990s which has made the economy one of the best performers in the OECD.*