GENERAL COMMENTS

There were many excellent responses to this year's examination. Most students attempted all questions and heeded some of last year's advice. Students allocated their time more appropriately and were therefore able to do justice to each part of each question, using the marks provided as a guide.

This year more students than usual were able to demonstrate current knowledge about the performance and management of the Australian economy. Students knew more about Australia's external stability, exchange rate variation and the factors that influence Australia's external performance, than in recent years. This was reflected in sound student performance on Question 1 in Section B.

Many students, however, continue to underperform in Section B because they do not take sufficient time to interpret what the question is asking them to do. Part of establishing good technique in this regard is to note the key 'directive' or 'command' word in the question. For example, a 'describe' question requires a less detailed answer (and therefore students are advised to spend less time in answering this question) than an 'analyse' question. So students need to familiarise themselves with the meaning of words such as:

- explain – give reasons and/or account for the situation; you may for example, give reasons about how something will benefit or improve a particular situation
- define – state precisely and fairly briefly the meaning of what you are being asked
- outline – briefly point out the essential features or characteristics of something
- evaluate – weigh up/judge/assess a situation by examining arguments for and against
- analyse – give a detailed comparison of causes and effects of how something has happened/developed (wherever possible use examples)
- examine – inspect the situation in detail by scrutinising the facts; to consider or discuss critically
- discuss – give a detailed explanation considering the possible outcomes and where possible offering support to your explanations.

Section A

This table indicates the approximate percentage of students choosing each distractor. The correct answer is the shaded alternative:

Question	A	B	C	D	Question	A	B	C	D
	%					%			
1	2	69	14	15	**9**	3	3	89	5
2	2	1	3	94	**10**	3	60	33	4
3	2	30	5	63	**11**	10	71	17	2
4	9	85	4	2	**12**	15	4	72	9
5	1	4	87	8	**13**	13	16	41	30
6	65	8	7	20	**14**	81	7	7	5
7	6	4	9	81	**15**	29	6	61	4
8	15	61	11	13					

Section B

Question	Marks	%	Response
Question 1	**a**		Students scored full marks on this question if they knew about key economic terminology and were able to explain this important concept in the current Australian context. Most students could say something about this concept but for full marks, students were expected to make the following points: • external stability means an economy has the ability to cope with short-term fluctuations in the balance of payments without undue pressure on the exchange rate or the onset of other adverse developments • it means being able to pay for trade transactions, pay interest commitments on external debt and repay, when necessary, borrowings from overseas • external stability involves avoiding a large balance of payments on current account to gross domestic product CAD/GDP ratio (in excess of 3% of GDP), large swings in the exchange rate and an unsustainably large and unproductive net foreign debt NFD/GDP with its associated heavy burden of debt servicing (in excess of 40% of GDP).
	0/3	14	
	1/3	21	
	2/3	26	
	3/3	39	
	(Average mark 1.89)		

	b 0/6 8 1/6 8 2/6 11 3/6 17 4/6 17 5/6 16 6/6 23 (Average mark 3.7)	The most important aspect of this question was an explanation of how factors affect the exchange rate. The question asks students to select 2 factors (a demand factor and a supply factor) and explain how this factor affects the value of the Australian dollar. A demand factor influences the level of spending and aggregate demand thus influencing the level of economic activity. For example, the level of interest rates is a demand factor when rates of interest increase. This means consumers must pay more for credit and/or they may defer expenditure because it costs more to borrow. This may lower personal consumption expenditure (C) leading to a fall in aggregate demand thus reducing the level of production, employment and economic activity. A supply factor affects the willingness and ability of producers to provide goods and services at a given price thus affecting the level of economic activity. These factors relate to any changes in the costs of production or to the quantity (number) or quality (efficiency) of factors of production available. For example, new mineral discoveries may be considered a supply factor. The number of productive resources increases which adds to the economy's productive capacity. This is likely to mean that the economy has the potential to produce more, leading to stronger economic growth and higher levels of economic activity. Most students were able to select a demand and supply factor. The choice in this question allowed students to select factors to demonstrate their knowledge and understanding and many students completed this question well. There was less confusion about the effects of domestic interest rates on overseas investment. More students were able to explain that high interest rates attracted overseas investment which increased the demand for Australian dollars ($A) thus an appreciation in the value of the $A. Although this question was well answered overall, many students simply stated the effect on the $A without explaining how the effect took place in terms of changes in demand or supply for the $A. Some students gave a good explanation but forgot to comment on the effect on the value of the $A as the question required.
	c 0/6 28 1/6 14 2/6 13 3/6 15 4/6 13 5/6 8 6/6 9 (Average mark 2.31)	This question was not well answered. Students must understand the relationship between changes in budget outcomes (budgetary/fiscal economic policy) and external stability (economic objective). One of the examination criteria refers to the need for students to demonstrate knowledge of the relationships which exist between economic objectives and economic policies. Students needed to situate their examination of the relationship in the current context. Most successful answers were able to talk about how recent budget surpluses may: • slow the rate of increase in foreign debt as the government reduces its need to borrow from overseas • reduce the burden of interest payments on foreign debt as well as being able to apply some of the surplus to pay back overseas loans • increase public savings. This helps improve Australia's national savings which assists in reducing the average size of Australia's current account deficit (CAD) over time. Other students referred to the impact of taxation reform such as how: • reductions in company tax may lower business taxes which means lower costs of production which assists Australian businesses to become more competitive, leading to better export performance and therefore a lower CAD • a reduction in income taxes increases disposable income which may increase demand for imports which may mean an increase in the CAD.

		There were signs that students were not clear on some important key knowledge. Many students found it difficult to explain the meaning of fiscal consolidation and the recent deficits and how the government has loosened its economic stance towards fiscal consolidation (many wanted a question on why the budget forecasts are inaccurate so they decided this was the best place to put it). Other common errors centered on the introduction of the goods and services tax (GST) and its impact. Some suggested that because the GST increased the price of goods and services, then more imports would be purchased. The inference being that there is no GST on imports. A valid answer to the question would have been that there is no GST on exports. Most students appeared to be unaware that the GST is passed on to the states, so they commented on the GST helping to increase the commonwealth budget surplus.
	di 0/3 29 1/3 10 2/3 15 3/3 46 (Average mark 1.78) **dii** 0/4 23 1/4 9 2/4 13 3/4 17 4/4 38 (Average mark 2.37)	This question was well answered. Most students talked about a reduction in tariffs in part i. An example of a quality answer to this part was: Free trade' or trade liberalisation is the idea that barriers to international trade should be removed. This is consistent with the belief in the benefits of strong competition which leads to better productivity, efficiency and innovation. A policy to promote free trade has been the reduction and removal of tariffs. A tariff is a tax on imports usually levied to protect domestic industries from the competition of cheaper imports. A tariff protects a particular industry at the expense of other sections of the economy. It protects selected domestic factories, jobs and profits but other sectors of the economy pay higher input costs. Goods carrying tariffs cost more and the consumers who use them pay higher prices. As part of its microeconomic reform policy, the commonwealth government over recent years has worked to lower or remove tariffs with a view to making Australian industries more efficient and competitive. If Australian business could not compete with global producers then it was forced to close down. The economic benefits and costs were extremely well answered in the second part of the question. It is pleasing to witness the growth in student knowledge and confidence about assessing the strengths and weaknesses associated with the implementation of microeconomic reforms such as the reduction or removal of tariffs.
Question 2	**a** 0/2 6 1/2 27 2/2 67 (Average mark 1.6)	The responses demonstrated a lack of understanding about the meaning of productivity. Students need to not only learn definitions of economic terminology, but also understand the meaning of these terms. Many responses defined productivity as output per worker. This is only one example of productivity that is, labour productivity. A broad definition of productivity should be provided such as – the amount of goods and services produced divided by the inputs used to produce them – before giving an example.
	bi 0/3 17 1/3 25 2/3 31 3/3 27 (Average mark 1.69) **bii** 0/3 12 1/3 24 2/3 38 3/3 26 (Average mark 1.77)	Less successful responses explained how increased production would lead to increased growth – missing the point of part a) asking for a distinction between production and productivity. Students need to read questions accurately and understand the meaning of key terms if they are to do themselves justice on the examination. Responses for Question 2bi) tended to repeat the quote that 'high productivity growth would provide a firm foundation for solid economic growth'. There is a lack of understanding of the economic growth relationships between productivity growth and economic growth. Students were not able to explain that productivity growth or increasing productivity means that the same amount of inputs – land, labour and capital – are able to produce more goods and services. More efficient use of the factors of production leads to more production and therefore stronger economic growth. In part 2bii) responses were generally quite clear on employment, income and standard of living connections.

	c 0/6 22 1/6 11 2/6 14 3/6 17 4/6 14 5/6 12 6/6 10 (Average mark 2.66)	Many responses focused on demand factors contributing to production/economic growth (again confusing production and productivity) rather than recognising that they needed to focus on the supply side aspects of productivity growth. The other important aspect of this question was that responses address factors that will contribute in coming years. Less successful responses talked about microeconomic reforms from the 1980s or early 90s without reference to issues for the coming years. More successful responses were able to identify relevant factors such as the use of information and communications technology and research and development, but most were unable to explain how these factors would be significant.
	d 0/6 8 1/6 7 2/6 12 3/6 18 4/6 23 5/6 17 6/6 15 (Average mark 3.54)	This question was generally well answered. Overall, responses were confident about the impact of these government actions on the level of domestic economic activity, although at times, the direction of the response was correct but lacked the detail required of an analysis. For example, it is true to say that an increase in G2 leads to increased economic activity but responses should then develop the analysis stepping through the argument about the impact on income, expenditure, production and employment. Students generally selected the government actions that they felt confident analysing. A popular choice was 'an increase in interest rates' and most responses were able to demonstrate a good understanding of the relationship between an increase in interest rates and the effect this would be likely to have on the level of domestic economic activity. However, the relationship must be thought about in a more analytical fashion. For example, when analysing how an increase in interest rates can affect economic activity, many responses say – *an increase in interest rates will decrease consumer confidence and therefore decrease aggregate demand.* Whilst it is true that interest rates will impact on confidence, it is not the main transmission mechanism. Responses need to include an explanation of the impact higher interest rates have on the cost of borrowing (and financing loans) and how this impacts on consumption, investment, etc; then to how confidence fits into the picture. Increased government investment expenditure (G2) was also a popular choice. Responses demonstrated some confusion about what exactly G2 is. It is important for students to master the definitions of key economic terms so that they are able to accurately respond to the questions asked.
Question 3	**a** 0/2 15 1/2 18 2/2 67 (Average mark 1.51)	Students should be reminded that reading meaning from graphs and charts is an important skill in Economics. Students should spend some reading time familiarising themselves with the data/graph/chart – for example, units used, the scales used, column/axis headings, highest and lowest values, noting relationships between variables. Students will then be in a more informed position to write a response about the material. As this question was only worth 2 marks, students really needed to keep their response brief and provide a key comment to describe the relationship. Some students misread the graph, thinking the scales for each variable was the same with the result that many commented that interest rates were higher than crude oil. Many responses also used the word 'compatible' to describe the relationship, when something like correlation would have been more appropriate.
	b 0/3 23 1/3 19 2/3 26 3/3 32 (Average mark 1.66)	This question required an understanding of the current government policy mix and the aims of those policies in the policy mix. It did not require an explanation of how monetary policy works in the current context. An example of a quality answer follows. This response clearly explains the Reserve Bank of Australia's current aim in setting monetary policy: The Reserve Bank of Australia's (RBA) current aim in setting monetary policy is its target for consumer price inflation of 2-3% on average over the business cycle. A rate sufficiently low that it does not materially distort economic decisions made by consumers and businesses.

		However, it is a mistake to think that this target means that the RBA cares only about inflation. The RBA sees low inflation as a means to an end – the end is low unemployment. The RBA is seeking the highest rate of economic growth that is consistent with its inflation target that is non-inflationary growth.
	c 0/5 31 1/5 17 2/5 16 3/5 17 4/5 11 5/5 8 (Average mark 1.84)	Students were required to describe the role of the target cash interest rate in the setting of monetary policy. That is, to really describe how monetary policy operates through the use of the target cash interest rate and the various transmission channels to achieve the aim of monetary policy. Responses needed to refer to the RBA setting a 'target' level for the cash rate and then manipulating the cash market via open market operations such that the target cash rate is 'hit' every day. Responses containing a description of how the RBA changes 'interest rates' more generally in light of a tightening or loosening of monetary policy were not really answering the question.
	d 0/4 47 1/4 18 2/4 14 3/4 9 4/4 12 (Average mark 1.23)	Students were required to use their economic knowledge about supply factors and apply it to this economic relationship. Many responses stated that if the price of oil rises, the RBA will reduce interest rates to compensate, even though this is contrary to the way they described the trend shown in the graph in part 3a). More successful answers built their explanation around the idea that increased world oil prices would be likely to cause higher petrol prices. Higher petrol prices increase the costs of production and could mean higher cost inflation is a consequence. If it looked like inflationary pressures were building the RBA would move to raise interest rates to head off any inflationary consequences.
	e 0/4 25 1/4 15 2/4 19 3/4 20 4/4 21 (Average mark 1.96)	This question allowed students to select another factor that may influence the RBA in its setting of monetary policy. Many responses were not able to identify such a factor. The most successful answers to this question were able to illustrate their explanation with excellent current knowledge; for example, if the target rate for inflation was hovering around the upper limit of 3% increase in the CPI and if household spending was growing very strongly, say due to strong employment growth and supported by rising wealth associated with increases in house prices (which was a factor in the increase in the cash rate in May 2002), it is likely that aggregate demand pressures would be building. If spending and demand increases and the economy is operating with fully utilised resources, these demand pressures may result in increased prices and demand inflation. The RBA may move to raise interest rates to reduce demand pressures as they did in May 2002.