



GENERAL COMMENTS

The standard generally displayed in student responses this year was improved over previous years. The performance on the multiple-choice section was similar to last year's, and some outstanding answers were given in Section B. It was clear that students who learnt and used economics terminology correctly, who engaged with current economic issues and developments and who understood economic relationships provided themselves with the best opportunities to excel in the Economics examination. It was also pleasing to note that there were few blank spaces in the answer booklets and students were prepared to attempt all questions.

Students should appreciate that Economics has a special language which requires understanding and use of a range of concepts and terminology. Students who learn, engage with and use these concepts and terms correctly perform strongly on the examination. In some instances, students were able to gain marks for simply defining these concepts and terms; for example, in Section B Questions 1c. and 2a. students were asked to define labour force participation rates and market mechanism and market failure. Too many students were unable to answer these relatively straightforward questions correctly.

SPECIFIC INFORMATION

Section A – Multiple-choice questions

Question	% A	% B	% C	% D
1	6	2	3	88
2	6	4	67	23
3	9	69	15	7
4	68	22	5	4
5	4	11	19	66
6	8	16	57	19
7	7	69	24	1
8	89	3	3	4
9	61	4	30	5
10	19	66	10	6
11	67	13	15	5
12	48	37	7	7
13	3	4	83	11
14	7	18	6	69
15	6	10	6	77

Section B – Written responses

Question 1a.

Marks	0	1	2	Average
%	4	25	72	1.7

Typical answers included comments about the relationship between interest rates, spending and demand. For example, 'relatively low interest rates (demand side factor) mean that consumers are more likely to purchase goods and services on credit as the costs of repayments are relatively low. This is likely to see a rise in private consumption expenditure (C), thus causing a rise in aggregate demand. This is likely to stimulate economic growth, thus resulting in an increase in demand for labour, which would in turn lead to a fall in the unemployment rate.'

The majority of students read the table correctly and described the steady downward trend in unemployment from June 2001, when the unemployment rate was 6.9 per cent, to June 2005, when the unemployment rate was 5.0 per cent.

Students should be reminded that when describing trends, better answers refer to specific statistics. A number of students added unnecessary information about the reasons for the trend, which meant they had less time to spend on the rest of the paper. A number of students did not read the question carefully and wasted time unnecessarily describing the trend from June 1994 to June 2000.

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Question 1b.

Marks	0	1	2	Average
%	20	21	59	1.4

There were a number of excellent answers which identified and concisely explained one demand factor, including relatively low interest rates, reduced marginal income tax rates leading to higher levels of personal disposable income, and strong world economic growth. Good answers correctly identified a demand side factor and then gave a relevant explanation about how the factor influences employment growth and therefore a reduction in unemployment.

A number of students were unable to identify a demand side factor and therefore performed poorly on this question. The most common error was selecting a component of aggregate demand, such as personal consumption expenditure, or an economic objective, such as economic growth, which were not demand side factors. A small number of students also confused the demand side with the supply side in their explanations.

Question 1c.

Marks	0	1	2	Average
%	29	45	26	1.0

The labour force participation rate is the labour force expressed as a percentage of the civilian population aged 15 years and over. The labour force comprises all those who are in employment plus those actively seeking employment.

Generally students had some knowledge about labour force participation rate, but few students were able to provide an accurate definition. Many students confused labour force participation rate with the unemployment rate, while others talked about an amount of people rather than the proportion or rate.

Question 1d.

Marks	0	1	2	3	4	Average
%	14	23	25	21	17	2.1

A supply factor affects the ability and willingness of firms to produce. The economy's productive capacity is the maximum amount of production when all productive resources are fully and efficiently employed. Increasing the productive capacity of an economy, and consequently increasing levels of aggregate supply and economic activity, requires an increase in the quantity (increased availability of resources) or quality (raised efficiency) of factors of production. The participation rate defines the potential supply of labour available to firms. Since labour is a productive input (factor of production), variations in the participation rate (quantity of factor of production) will impact on the economy's ability to supply output. So an increase in the participation rate, for example, means more labour resources are available which will increase a firm's ability and willingness to supply/produce goods and services.

Generally this question was poorly answered. Surprisingly, a significant number of students who did not satisfactorily answer part c. indicated in their answers to this question that they had a reasonable understanding of the labour force participation rate. However, students generally did not appear to have a well-developed understanding of the supply side and found it difficult to explain how supply factors work to improve a firm's willingness and ability to supply or expand production.

There still appears to be confusion between the terms 'production' and 'productivity', with a number of answers indicating that students were not clear about the meaning of these terms. Some answers lacked sufficient explanation – many students asserted that an increase in the labour force participation rate would increase productivity, without explaining **how** this would happen, despite the question asking them to 'explain'. Assessors cannot award marks for assertions that are not backed up by explanations.

A number of students did not seem to understand the nature of the term 'productive capacity', giving statements such as 'an increase in the labour force participation rate will move the economy **closer** to productive capacity' rather than 'an increase in the labour force participation rate will **increase** the economy's productive capacity'.

Question 1ei.

Marks	0	1	2	Average
%	19	31	49	1.3

Better answers correctly identified the possible contribution to improved productive capacity and stronger economic growth, issues associated with the skills shortages and/or the ageing of Australia's population.

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Many students again confused the labour force participation rate and the unemployment rate. As a result many of the answers given related to reasons for lowering the unemployment rate rather than increasing the labour force participation rate.

One common misconception was that increasing the labour force participation rate would mean a decrease in welfare benefits because fewer people would be unemployed. Some weaker students seemed to believe that 'participation' actually meant having a job.

Question 1eii.

Marks	0	1	2	3	4	5	6	Average
%	16	11	14	17	16	12	15	3.0

A wide range of policies were discussed by students in answer to this question, including the following.

- Redesign the welfare system to provide incentives to make people move off welfare and/or to compel welfare recipients to seek work. For example, the 2005/06 Budget introduced measures so that parents on welfare will generally be required to seek part-time work if their youngest child is aged 6–15.
- Redesign the welfare system so that people with disabilities applying for welfare who can work part-time will be required to seek part-time employment.
- Keep older workers attached to the labour market past the traditional retirement age by, for example, creating more adaptable retirement income and superannuation arrangements and/or removing compulsory retirement age.
- Reform taxes, as high marginal income tax rates can discourage labour supply. Cutting these rates, as has been done in recent budgets, might be a means of encouraging more labour force participation. For example, in 2006/07 Budget, the 42 per cent marginal tax rate will be cut to 40 per cent and the threshold will rise to \$75 000.
- Increase female participation rates; for example, through improved access to child care.
- Attach more people to the labour force through WorkChoices and other labour market reforms that lead to more flexible work arrangements.
- Offer more training, apprenticeships, etc. to attach more people/provide incentives to become employed.

It was important for students to develop their explanations fully, given that the question was worth six marks. Students who responded well offered a clear explanation of why the policy they selected was likely to increase the labour force participation rate. Students needed to display clear economic thinking and justify their choices in order to show their understanding of economic relationships. For example, many students used the new WorkChoices policy as their example but did not follow through with sufficient explanation. Many students simply stated that WorkChoices will encourage people to apply for work because workers will be so much better off; however, the logic behind this statement needed to be explained. Many stated that employers will be more inclined to employ people because they will be able to sack them when they are no longer required. Even though this may be a valid argument, these students displayed a misunderstanding that the labour force participation rate is about the actions of employees not employers.

Question 2a.

Marks	0	1	2	3	4	Average
%	20	17	20	22	21	2.1

- Market mechanism refers to the pricing system in which consumers and producers in markets interact, reacting to changing price signals **or** the combination of supply and demand forces leading to price adjustments that ensure an efficient allocation of resources.
- Market failure is a situation where, because of imperfections in the working of the market mechanism, markets do not achieve an efficient allocation of resources. Examples include monopoly, which may lead to underproduction and over pricing relative to an efficient outcome, and externalities where some aspect of agents' activities are not priced by the market but nevertheless affect other agents.

There was a tendency for some students to simply give an example of market failure rather than defining its meaning, which meant that full marks could not be awarded.

Question 2b.

Marks	0	1	2	3	4	5	6	Average
%	11	10	12	16	17	15	19	3.4

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The best answers generally identified a reason for government intervention in markets, described the reason and commented on the government's policy response. Most students identified and described two reasons, but then had difficulty providing evidence for their answers with details about the government's response.

Better responses made reference to merit goods, demerit goods, public goods, monopolies, dangerous goods, negative externalities and poor income distribution. However, students who spoke about budgetary policy and other areas of microeconomic reform found the task more difficult. For example, using the reduction of tariffs as an example was problematic because the imposition of the tariff in the first place was the intervention, and its removal would be an attempt to return to the pure market.

Question 2ci.

Marks	0	1	2	3	4	Average
%	9	18	25	24	25	2.4

A typical answer included comments about allocation of resources and inputs. For example, 'an efficient allocation of resources means that productive inputs (factors of production – land, labour, capital and enterprise) are being used in a way that achieves the maximum possible social benefit. In the absence of this, resources will be wasted, ensuring that the best possible output mix from a given set of resources is not achieved. This will impinge on the economy's rate of growth as the economy's potential output will not be realised.'

In answering this question, students needed to describe the relationship between the objectives. Better responses identified this relationship as being fundamentally compatible and described how, for example, achieving an efficient allocation of resources is likely to lead to strong and sustainable economic growth.

Weaker responses tended to give vague descriptions of the two economic objectives without trying to relate them, while others gave only a basic description of the relationship. Some students gave very thorough descriptions of the two objectives, but did not identify the relationship.

Question 2cii.

Marks	0	1	2	3	4	5	6	7	8	Average
%	17	8	12	13	15	12	12	6	4	3.4

The sorts of budgetary policies (BP) and microeconomic policies (MER) examined included:

- taxation reforms, such as a reduction in marginal income tax rates aimed at increasing incentives to work, increasing participation rates and/or increasing economic growth (could be BP or MER)
- welfare reforms designed to increase participation rates and therefore increase economic growth (could be BP or MER)
- labour market reforms, for example WorkChoices, which aim to increase labour market flexibility with a view to providing more incentives for business to employ more workers, resulting in higher levels of economic growth (MER)
- competition policies, including corporatisation of state government utilities (water, gas and electricity) and privatisation (such as the further privatisation of Telstra), which continue to expose these businesses to competition and therefore promote better efficiencies and higher rates of economic growth (MER and possibly BP)
- more spending on infrastructure such as road and rail to enhance economic efficiencies and therefore achieve higher economic growth (BP)
- budget surpluses, which lead to relatively lower interest rates (BP)
- automatic stabilisers (BP)
- the 'baby bonus' and other increases in family allowances that could raise personal consumption spending (C) and aggregate demand, thus increasing economic growth (BP).

The introduction of the GST, the floating of the Australian dollar, the deregulation of the airline industry and privatisation of the Commonwealth Bank were policies outside the scope of the question and therefore were not awarded marks.

This question proved to be very challenging for students. When approaching questions that require responses to a number of aspects, students should spend a few minutes planning their response so that their answer covers all that is required by the question.

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The best answers gave examples of budgetary and microeconomic policies that have been used over the past three years, explained their impact on economic growth and efficiency and commented on the relationship between these policies in the policy mix. As a policy mix question, better students were able to comment on how the use of microeconomic reform policies has supported the government's endeavours to continue to achieve surplus budgets. However, many students who gave adequate descriptions of policies did not refer to their interrelationship and therefore could not score full marks.

Weaker answers often resulted from students failing to read the last part of the question, 'over the past three years', and consequently describing budgetary and microeconomic policies which occurred well over three years ago. Other students gave a very theoretical discussion without making any specific reference to the last three years.

Question 3a.

Marks	0	1	2	3	4	Average
%	13	14	21	24	28	2.4

This year more students made correct economic links between world economic growth and Australian economic growth, with many students providing current examples to illustrate their understanding; for example, the effect of strong economic growth in China flowing through to the Western Australian economy in particular. This again illustrates the importance of students having an awareness of current events.

Although this question was generally well answered, there were a couple of areas where students seemed to lack full understanding. For example, while the majority of students correctly described the impact on the rate of inflation, it was only occasionally linked to the current situation of capacity constraints. Furthermore, there seemed to be some misconception by students that if the rest of the world is growing then Australia is falling behind (it is like a 'big economic race' and if the world is growing faster than us then Australia will suffer).

Question 3b.

Marks	0	1	2	3	4	5	6	Average
%	25	12	12	13	14	14	10	2.6

The best responses showed that strong world economic growth would stimulate the Australian economy and realised that contractionary budgetary and monetary policies would likely be required. Some students also correctly suggested that the budget may need to provide for increased infrastructure to meet the increased demand from overseas, which may be considered expansionary.

A number of poor responses suggested that the Australian economy is in some sort of competition with the rest of the world and therefore the government would implement expansionary budgetary and monetary policies to increase Australian economic growth and thus win 'the competition'.

Again, some students did not read the question carefully and viewed it as a question on strong Australian economic growth which, unfortunately, meant that these responses scored low or no marks.

Question 3c.

Marks	0	1	2	3	4	Average
%	7	14	28	21	29	2.5

There were some impressive answers for this question with the majority of students understanding the reasons for higher oil prices. The question gave students the opportunity to demonstrate their understanding of current economic events and their impact on the oil market. Many students correctly identified a supply issue, such as the instability in the Middle East, Hurricane Katrina, or supply problems in Alaska, Venezuela or Africa, while others identified the major demand factor related to growing global demand, particularly in China and India.

Question 3d.

Marks	0	1	2	3	4	5	6	Average
%	10	10	15	18	16	17	14	3.3

Students who attempted the first option generally gave a good analysis of the effect on interest rates. The impact on inflation was linked to the possibility of the Reserve Bank of Australia raising interest rates. Some of the better responses identified the fact that in some circumstances the rise in oil prices could be regarded as a 'de-facto interest rate rise', with a similar impact on discretionary income. Therefore, if demand in other areas of the economy was weak,

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an interest rate rise could prove to be counter-productive. Some students, however, made the mistake of then using this phenomenon as justification for an interest rate decrease.

Fewer students selected option two, the value of the dollar, and in general it was not handled well. Many students suggested that Australia's international competitiveness would suffer because there would be higher production costs, failing to understand that everyone else also pays the same price for a barrel of oil (at least before taxes).

Option three, the equity in personal income distribution, was generally satisfactorily handled. Students discussed the fact that equity outcomes are likely to be worse if higher oil and petrol prices lead to worsening inflation, as higher inflation distorts the distribution of income. Students argued that the demand for petrol is probably inelastic and that petrol is a relatively large component of the household budget for low income households. Higher petrol prices may therefore be expected to make the distribution of income more unequal.