2009 Economics GA 3: Examination

GENERAL COMMENTS

The standard of answers in Section B continues to improve. Students demonstrated an improved understanding of current economic events and issues and how these are likely to impact the performance of the Australian economy and cause changes in government economic policies. Students generally performed well when answering Section B Questions 2b., 2c., 2d. and 4a.

However, while this is a very positive development, some students showed a lack of depth in their understanding of a number of important theoretical concepts, including the market (price) mechanism and demand and supply analysis, market failure, strong and sustainable economic growth, and economics relationships such as lower rates of inflation and how this might effect equity, and how microeconomic reform policy affects efficiency. This meant that a number of questions were generally not well answered, including Section A, Questions 2 and 9 and Section B, Questions 2d., 2e., 3a., 3b. and 3c.

It has been emphasised in past Assessment Reports that to score highly students must understand key economic definitions. There were a number of questions in both Section A and Section B of the 2009 paper where it was expected that students would score full marks if they were clear about key economic definitions. For example, Section B Questions 1a., 2a. and 3a.

It is also important to note that high-scoring responses answered the required question directly, generally taking a structured approach. For example, in Section B, Question 2e., answers scoring the highest marks tended to commence with a definition of each policy and what is meant by economic downturn or recession. These responses then compared the effectiveness of the policies by pointing out a number of strengths and weaknesses of each policy in reducing the effects of an economic downturn or recession. Usually two strengths and two weaknesses for each policy which were well explained and compared the effectiveness of each policy were sufficient to score high marks. Students who were able to set their discussion in the current context by pointing out the strengths and weaknesses related to effectiveness over the past year also scored high marks.

Section A –Multiple-choice questions

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

Question	% A	% B	% C	% D
1	2	2	95	1
2	43	44	7	5
3	7	18	53	23
4	15	8	22	55
5	47	26	14	13
6	9	17	73	1
7	3	0	1	96
8	65	23	8	4
9	19	22	45	15
10	56	16	6	22
11	5	7	5	84
12	7	10	78	4
13	70	6	12	11
14	4	13	80	4
15	10	12	63	16

Section B – Written responses

Question 1a.

Marks	0	1	2	Average
%	22	38	40	1.2

To score two marks for this question, students needed to outline that an equitable distribution of personal income is about ensuring that all citizens have sufficient income to be able to purchase basic goods and services necessary for survival. Equitable refers to the idea of achieving a distribution that is 'fair', not 'even'. Weaker answers tended to confuse the notion of equity with equality.

Question 1b.

Marks	0	1	2	3	4	Average
%	8	16	24	30	22	**2.4**

Better answers gave one of the following explanations about the impact of falling levels of inflation in Australia:

- lower inflation may assist in job growth. More people are working, so there is less reliance on transfer income and more equitable outcomes are possible
- lower levels of inflation may help to prevent a reduction in the value of real wages or real income and therefore may also be better for equity.

Students generally responded well when asked to explain the impact of rising levels of unemployment in Australia on equity in personal income distribution. The better answers generally explained that being employed usually acts as a 'safeguard' so the likelihood of experiencing absolute poverty is lessened. Therefore, a rise in unemployment is likely to mean fewer people are earning factor income with more being dependent on transfer income, so inequality is likely to grow or less equity results.

The second part of the question was poorly answered. Many students were not able to distinguish between lower rates of inflation and their impact on equity and instead discussed the impact of deflation. By discussing the impact of deflation rather than lower rates of inflation, many students showed that they did not understand the difference between real and disposable income, suggesting that lower inflation is likely to increase disposable income.

Question 1c.

Marks	0	1	2	3	4	5	6	Average
%	11	8	14	19	21	17	11	**3.3**

A number of students demonstrated good current knowledge in answering this question. They were able to use recent changes in government budgetary policy to illustrate how these changes may impact positively on equity, for example, the fact that only low and middle-income earners received the fiscal stimulus payment in early 2009.

A number of students, however, struggled to provide two government policy actions, suggesting that these students may not have engaged specifically with the way that policies in theory may be used to achieve a more equitable distribution of personal income in Australia. Even when some theoretical policies were identified, students struggled to make clear links between the policy application and its impact on achieving better equity outcomes. For example, when students selected the implementation of progressive income taxes, many simply stated that as income rises, the amount of tax paid increases, rather than making it clear that progressive taxes are about the **rate** of tax increasing as income rises, thus redistributing incomes more evenly. For example, if you earn $50 000 per annum you pay 30% tax, but if you earn $100 000 per annum the rate for every dollar earned over $50 000 might be 40%, thus improving equity outcomes.

Other policy actions that were used successfully in this question included:

- increasing the tax-free threshold from, for example, $5000 to $8000. This raises the amount that can be earned before paying tax, thus improving access to income for low-income earners
- provision of government services such as health services at no or low cost for those on very low incomes or on welfare
- improving access to income earning opportunities, for example, by providing more funding for education and training or for government schools
- using transfer income and welfare payments to support those with no access to income because of, for example, advanced age or illness
- means and assets testing of benefits such as old age pensions, family allowance, Austudy and Baby Bonus.

Question 2a.

Marks	0	1	2	3	4	Average
%	9	18	26	31	16	**2.3**

High-scoring answers included points such as the following.

- Strong and sustainable economic growth and full employment are considered compatible objectives.
- If the economy is growing due to, for example, higher levels of personal consumption spending leading to stronger levels of aggregate demand, then if output is to rise to meet this demand, jobs will be created. This

will lead to employment growth/lower unemployment (that is, higher rates of production result in an increased derived demand for labour).

- Strong and sustainable economic growth is about achieving a rate of increase in production or gross domestic product that is compatible with the achievement of other objectives such as low inflation and external stability.

A large number of students were unable to score full marks for this question because they did not refer specifically to the last dot point – what is meant by strong and sustainable economic growth.

Question 2b.

Marks	0	1	2	3	4	Average
%	11	13	21	21	34	2.6

This question was generally well answered. The majority of students suggested that the impact of the global financial crisis over the past year had meant that economic growth had generally slowed. A large number of students were able to correctly identify and explain pertinent factors, demonstrating sound, current knowledge about the performance of the Australian economy.

Weaker answers tended to correctly identify a relevant factor but then did not fully develop their answers by explaining the link between the factor and how the production of goods and services was likely to be affected.

The following is an example of a good response to this question.

Economic growth in Australia has slowed over the past year. One domestic demand factor that may have slowed economic growth may have been a fall in consumer confidence due to rising unemployment levels and concerns about the state of the economy following the impact of the global financial crisis (GFC) in 2008. This may have reduced levels of personal consumption expenditure and thus aggregate demand and economic growth. One global demand factor affecting economic growth was that the GFC has seen a serious deterioration in global confidence and global demand, thus reducing Australia's export demand (which is part of aggregate demand) therefore slowing Australia's economic growth.

Question 2c.

Marks	0	1	2	3	4	Average
%	9	7	19	29	36	2.8

This question was generally well answered, demonstrating high levels of student engagement with the current performance of the Australian economy. Better answers suggested that fiscal policy has responded in two ways: firstly, by allowing the Budget's automatic stabilisers to change direction and turn the budget surplus into a deficit as tax revenue falls while government spending on unemployment benefits increases, and secondly, by adding discretionary fiscal stimulus onto the effect of the automatic stabilisers through cash grants, new spending programs to assist job seekers and spending on capital works. Students used a range of budgetary/fiscal policy actions to illustrate how budgetary/fiscal policy has been used to support economic growth and jobs, including:

- running government budget deficits (in Keynesian terms, to have an expansionary effect)
- very soon after the culmination of the global financial crisis in September 2008 the government began announcing budget measures intended to stimulate demand in response to looming recession. In October 2008 it announced an 'economic security strategy' worth $10.4 billion, involving cash payments to pensioners, carers and parents, plus temporary increases in the first home owner grant. These payments were made in mid-December 2008
- in February 2009 the Commonwealth announced a 'nation building and jobs plan' worth $42 billion, involving cash bonuses of $900 or $950 each to most taxpayers, single-income families, parents, some students and farmers, with a cost of $12.7 billion. The remainder of the $42 billion was to be spent on 'shovel-ready' minor capital works, including road black spots, rail crossings, public housing and maintenance and building work at every primary school in Australia
- between the stimulus packages there was a Council of Australian Governments reform package (worth $15.2 billion)
- the main stimulus measure announced in the May 2009 Budget was the $22 billion program of major infrastructure projects. However, any increase in government spending or cut in taxation has a stimulatory effect on the economy, whether or not it is included in a 'stimulus package'. Thus the tax cuts in July 2009 and the pension increases will help to stimulate demand
- government infrastructure expenditure, for example, increasing jobs in school libraries
- a further round of income tax cuts from July 2009, costing about $2.6 billion in 2009–10
- the 2009–2010 Budget announced a temporary investment allowance for small businesses

- in the 2009–10 Budget, Mr Swan announced new spending of about $8 billion in 2009–10, including special increases in the age pension, the paid parental leave scheme, a brief extension of the temporary increases in the first home owner grant, and additional spending on training and assistance for retrenched workers.

However, students needed to make sure that once they identified a specific policy they were then able to clearly explain how the policy action was likely to stimulate an increase in production (raise economic growth) and create employment.

Question 2d.

Marks	0	1	2	3	4	Average
%	14	11	25	31	19	2.3

It was expected that students would explain how an expansionary fiscal policy stance had been supported by an expansionary monetary policy stance with a lowering of interest rates (interest rates were reduced six times between September 2008 and April 2009). While interest rates remain at relatively low levels, a number of able students also suggested that this complementary stance lasted until October 2009 when interest rates were raised. This is likely to support consumers and businesses in their credit-based spending, thus supporting higher levels of personal consumption expenditure (C) and private investment expenditure (I) and therefore supporting higher levels of aggregate demand, higher rates of economic growth and job creation.

A number of students demonstrated sound understanding of the relationship between budgetary/fiscal policy and monetary policy. However, weaker answers did not mention the relationship and talked only of how monetary policy works in theory, thus they were unable to score high marks. While it was pleasing that nearly all students understood that lower interest rates tend to have an expansionary effect on the economy, a large number of students were unable to explain why and how this is so. It was expected that reference to at least one transmission mechanism be made to explain understanding of how monetary policy operates. Disappointingly, too many students also talked about an increase in disposable income with respect to a decrease in interest rates, when the correct terminology should be a change in levels of discretionary income. Weaker answers failed to make clear the connections between changes in the policy operation and their effect on the production of goods and services, economic growth and employment. Students need to make sure they fulfil all requirements of the question in order to score high marks.

Question 2e.

Marks	0	1	2	3	4	5	6	7	8	Average
%	13	11	14	14	16	12	10	6	4	3.4

Generally, the best answers to this question were provided by students who planned their answer. They commenced with a definition of each policy and what is meant by economic downturn or recession. They then set about comparing the effectiveness of the policies by pointing out a number of strengths and weaknesses of each policy in reducing the effects of an economic downturn or recession. Usually two well-explained strengths and two weaknesses for each policy were sufficient to score high marks.

Strengths and weaknesses used by students included reference to the following examples.

Budgetary policy – strengths

- The role of automatic stabilisers: operate automatically to support the economy in a downturn such as injecting more cash into the economy through increased unemployment benefits as unemployment rises.
- Is flexible in that policy actions can be implemented at any time, for example, the fiscal stimulus packages over the past year.
- Is direct, as the policy action can target specific groups and projects and therefore may be considered more effective than monetary policy.
- The policy measures contained in the fiscal stimulus were based on three principles; that is, they needed to be timely, targeted and temporary. Timely means they should take effect as soon as possible, targeted means the spending should go to those people or activities which are most likely to involve spending rather than saving, and temporary means they should involve a one-off cost to the Budget (for example, cash bonuses and specific capital works) rather than a continuing cost (for example, tax cuts and pension increases).

Budgetary policy – weaknesses

- Implementation lag may be longer than with monetary policy, for example, infrastructure projects may take a long time to get up and going.
- It is difficult to ensure that cash handouts that may be allocated are spent and/or have the desired multiplier effects. This may be because some is saved; some is spent on imports and overseas trips. Stimulus spending by

governments is intended to have ‘multiplier effects’. Empirical research shows, however, that because of leakages to saving and imports in particular, the multiplier effects are much smaller in real life than in textbooks.
- The political problem of getting budget initiatives through the Senate if government does not have a majority.
- Impact of running deficits – issues of how to finance, pressures on interest rates, issues of confidence, issues around credit availability, how deficit financing may impact size of foreign debt.

Monetary policy – strengths
- Not the same level of political angst related to monetary policy implementation given the Reserve Bank of Australia’s (RBA) independence.
- May be more flexible than budgetary policy – can vary the size of interest rate variation and can make variations on a monthly basis if necessary.

Monetary policy – weaknesses
- Lag impacts.
- Blunt instrument because they are unable to discriminate between groups in the economy.
- Lower interest rates do not necessarily make people spend if confidence is low.
- Over the past year, banks did not necessarily pass on whole interest rate cuts.

Question 3a.

Marks	0	1	2	3	4	Average
%	21	23	26	20	10	1.8

This question was the worst answered question on the paper. A number of key economic theoretical concepts appear to be not well understood by students. Weaknesses evident in student responses included:
- many students do not understand the role of relative prices in the allocation of resources. They were unable to identify their signalling function and how markets are interrelated
- many seemed to simply state all they knew about markets without making reference specifically to the requirements of the question
- many students wanted to talk about efficiency in resource allocation, which was not what the question was asking.

Better responses were able to make this sort of explanation: the price mechanism describes how the forces of demand and supply determine relative prices of goods and services which then ultimately determines the way productive resources; for example, land, labour, capital and enterprise are allocated in the economy. As prices change in various markets, for example, because demand is very strong, it sends a signal to suppliers that profit opportunities exist if they direct their resources into those areas experiencing higher demand. The changing conditions in the market have caused a change in resource allocation.

Question 3b.

Marks	0	1	2	Average
%	26	34	40	1.2

Externalities – A negative externality is a cost associated with the production or consumption of goods and services where these activities have negative ‘spillover’ effects which are passed onto others. For example, climate change is the result of global warming. Global warming may be considered a form of pollution as producers and consumers contribute to the build up of CO2 emissions through their daily economic activities. This build up of greenhouse gas is not factored in as a cost of the production or consumption activity; however, the resultant climate change will have spillover or third party effects/costs for future generations. Governments may intervene by imposing a tax on CO2 emitters.

Students appeared to be much more aware of issues related to market failure, although there was still some confused thinking evident. In order for students to respond positively to this question it was important that they understood that market failure occurs when individuals’ (consumers or producers) pursuit of self-interest leads to a situation where resources are allocated in ways that do not maximise national living standards and the economic welfare of all members of society. The belief that markets can ‘fail’, that is, that markets may have inefficient outcomes, was used as a common justification for government intervention in markets.

Better answers provided the following sorts of explanations: in relation to public goods, examples of 'public goods' provided by the government include street lighting, prisons, defence services and lighthouses. Public goods may be provided by the government because one person's consumption does not diminish the ability of another person to enjoy the same consumption and non-payers cannot be excluded from enjoying the benefits that the good or service provides.

Question 3c.

Marks	0	1	2	3	4	Average
%	22	15	23	22	18	2

Examples of microeconomic reform policies which were discussed well included:

- since 2006, 'National Reform Agenda' was the name given to carry forward reforms in three key areas: human capital, competition and reduced regulation. These reforms are about improving efficiency. Reforms related to human capital were aimed at boosting the proportion of the working-aged population that is able to work with, for example, incentives provided to older Australians to encourage them to stay at work. Governments are also working to improve education and skills through policies which increase retention rates, set national literacy and numeracy targets, devise a national curriculum, invest in early childhood education and access to computers. Competition reforms are targeted at introducing proper price signals for vital infrastructure. For example, water reforms were a major emphasis in 2009, aimed towards creating a national market for water, with prices that accurately reflected its scarcity. Another focus has been on achieving reduced regulation with 10 areas of overlapping state and federal laws which impede the ability of business across state boundaries have been identified as areas for action. For example, state and federal governments this year agreed to harmonise laws on occupational health and safety, the multiplicity of which has been an irritant for business and a barrier to producing across state boundaries. The Rudd Government has indicated it will carry on with these reforms and add extra areas for action including, for example, climate change and indigenous reforms
- changes to the labour market through WorkChoices to improve labour efficiency and thus increase economic growth
- privatisation: for example, the sale of T3 (Telstra) – this was based on the belief that competition provided in competitive markets exerts more pressure on businesses to be more efficient, thus allowing for stronger economic growth.

Some students struggled with this question as they were unable to select one appropriate microeconomic reform policy. Other weaker answers failed to make a link between the selected policy and its ability to achieve a more efficient resource allocation.

Better answers discussed how the selected policy may be considered a supply side measure which seeks to alter the way particular industries are structured and organised so that they become more efficient and internationally competitive. They also explained that an efficient allocation of resources is achieved when resources are allocated in such a way that they maximise the welfare or living standards of all citizens. The most efficient allocation of resources implies that all types of efficiency are at their maximum. Greater efficiency in the way resources are allocated will normally result in more output being produced from the same quantity or fewer inputs (higher productivity).

Question 4a.

Marks	0	1	2	Average
%	26	23	51	1.3

This question was generally well answered with students recognising that over this period the Australian dollar depreciated. The sorts of factors used to explain the depreciation included:

- there was a slump in world demand for Australian exports due to the global financial crisis, which resulted in very slow world economic growth. This meant that there was a reduction in demand for Australian dollars, thus leading to depreciation
- there was a slump in commodity prices (such as for mineral resources) due to the effects of the global financial crisis and very slow world economic growth. Australia is a commodity exporter; therefore a fall in demand for exports leads to less demand for Australian dollars and depreciation.

Question 4b.

Marks	0	1	2	3	4	Average
%	28	16	24	15	17	1.8

Most students were able to correctly explain a likely effect of the depreciation on Australia's balance of payments on current account deficit (CAD). Most correctly suggested that depreciation may lead to an increase in export demand due to Australian exports now being cheaper and less import demand because imports are more expensive, therefore there is an improvement in the size of the CAD.

However, the second part of the question was not as well answered with many students confused about the likely impact of depreciation on Australia's inflation rate. The better answers suggested that the effects of the depreciating Australian dollar meant that imports were relatively dearer. This increased cost of imports may lead to increased inflationary pressure as import prices rise and imported component parts become more expensive, adding to production costs and inflationary pressure may increase in Australia.

Question 4c.

Marks	0	1	2	3	4	Average
%	11	17	24	25	24	2.4

Net foreign debt is made up of the value of borrowing abroad by Australian private businesses and households (private foreign debt) plus the Australian Government borrowing from abroad (public foreign debt). Trends for private foreign debt showed that it increased quite significantly from 2000 but has levelled off recently, while trends for public foreign debt have levelled off since 2000 with no debt shown in 2007, but it has tracked up somewhat since 2008.

A number of students found it difficult to describe a trend in the time frame indicated (since 2000) to fully answer all question requirements and/or did not know the difference between private and public ownership.

Question 4d.

Marks	0	1	2	3	4	Average
%	18	17	25	22	18	2.1

A majority of students could explain an impact on Australia's total net foreign debt. Students commented that public foreign debt trended down from 1996 as the Commonwealth ran a series of budget surpluses which required no call on overseas borrowings, and that this allowed the Commonwealth Government to retire their public debt. However, in 2008 and 2009 there was a return to running budget deficits. These deficits must be must be funded – one way to fund is to borrow from overseas (selling bonds to overseas investors/lenders). This may mean public debt trends up, which could add to overall increased size of net foreign debt.