2017 VCE Economics examination report

General comments

The 2017 VCE Economics examination was the first for the new *VCE Economics Study Design (2017–2021)*. The examination was generally well handled by the majority of students. Most students attempted all questions and appeared to do so with a reasonable degree of confidence.

Some students appeared to run out of time, not leaving themselves time to develop responses to the eight-mark questions in Section B, but most students seemed to manage their time effectively, creating the best opportunity to score optimum marks.

Most students handled Section A well and there were many high-quality responses in Section B. Most students performed well in Question 2, Section B, and demonstrated that they were able to construct and interpret demand and supply diagrams accurately. Students also demonstrated an ability to interpret and analyse graphical data, as evidenced by the high standard of responses to Questions 4a. and 5a. in Section B.

Areas noted for improvement include the need for students to:

- use the mark allocation in questions in Section B as a guide to the extent of the response required. For example, some students wrote long answers to questions such as Questions 1a. and 4b. in Section B, which were worth two marks each, and then did not leave themselves enough time to develop more detailed responses to questions worth six or eight marks
- build greater understandings related to the command terms used in Section B. This is important so that students write precise answers that respond explicitly to the question requirements. For example, Question 4a. in Section B asked students to assess the extent to which Australia has been able to achieve its goal of low inflation in 2016–2017. 'Assess' means that students were required to make a judgment related to the extent to which Australia had been able to achieve its goal of low inflation. Very few students did this and instead wrote a description of the trend in the graph, without weighing up the extent to which the goal of low inflation was achieved. Question 3e. in Section B asked students to evaluate one strength and one weakness of using each of budgetary policy and monetary policy in achieving increased jobs and growth. Most students ignored the evaluation aspect of the question and tended to simply list strengths and weaknesses, without making a judgment and stating their opinion about the strengths and weaknesses in terms of achieving increased jobs and growth
- ensure closer reading of the study design headings, outcomes, introductions to Areas of Study, key knowledge and key skills so that they develop a full understanding of them. There was some lack of awareness demonstrated; for example, in Question 3d. in Section B, students were asked to explain how aggregate demand policies have influenced jobs and growth and many were unable to identify and use both budgetary policy and monetary policy in their responses even though the heading in the study design for Area of Study 1 in Unit 4 on page 24 is 'Aggregate demand policies and domestic economic stability'. There was also a small number of students who failed to realise that external stability and equity in income distribution are not part of the section related to domestic macroeconomic economic goals in the current study design
- define and use economic concepts and terms with greater accuracy and precision. For example, there was a level of confusion around definitions of production and productivity;

public goods and common access resources; aggregate demand and aggregate supply policies; budget deficits and current account deficits
- continue to develop a thorough knowledge of the economic factors and policies that have influenced the performance of the Australian economy for the past two years – that is, for the years 2016 and 2017 for the 2017 examination. If students had developed deeper understandings related to factors and performance, answers to Questions 3a., 3d., 4a., 4b., 4c. and 5a. in Section B, for example, would likely have been enhanced
- further develop understandings of economic relationships and cause-and-effect linkages. For example, many students were unable to demonstrate full understandings of the nature and operation of aggregate supply policies and analyse how the policies may influence the domestic macroeconomic goals, which was a requirement in Question 3b. in Section B.

Specific information

This report provides sample answers or an indication of what answers may have included. Unless otherwise stated, these are not intended to be exemplary or complete responses.

The statistics in this report may be subject to rounding resulting in a total more or less than 100 per cent.

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	Comments
1	1	0	98	1	
2	11	13	11	64	
3	96	1	1	2	
4	9	3	84	4	
5	1	87	9	3	
6	76	5	14	5	
7	40	56	1	3	
8	7	5	73	15	
9	13	8	3	76	
10	82	13	2	2	
11	59	38	1	2	Both options A and B were accepted as it was difficult to distinguish between dynamic efficiency and allocative efficiency based on the information provided in the question.
12	2	6	6	86	
13	3	90	3	4	
14	10	13	72	5	
15	2	5	86	7	

Section B – Written responses

Question 1a.

Marks	0	1	2	Average
%	10	34	56	**1.5**

Higher-scoring responses explained how one or more characteristics of competitive markets affected the efficiency of resource allocation, linking their explanation to a particular type of efficiency. Lower-scoring responses struggled to link an aspect of a competitive market to the impact on efficiency of resource allocation.

Question 1b.

Marks	0	1	2	3	Average
%	11	17	24	48	**2.1**

Higher-scoring responses to this question accurately defined public goods and common access resources and distinguished between these terms by pointing out a difference between them – for example, public goods are non-rivalrous in consumption and common access resources are rivalrous.

Some students were unable to score full marks because they used terms such as 'non-excludable' or 'rivalrous' without explaining these terms and thus did not demonstrate a full understanding of these concepts.

There was also evidence of some confused thinking in some responses, and these responses could not score high marks. For example, some students mixed up the meanings of non-excludability and non-rivalrous. In other cases, students made inaccurate selections of examples related to public goods and/or common access resources – for instance, many students stated that hospitals and schools were examples of public goods, not understanding the non-rivalrous concept. Also, some students talked about 'over-allocating' resources to common access resources rather than saying that resources will be over-consumed.

Question 1c.

Marks	0	1	2	3	Average
%	21	16	27	36	**1.8**

Knowledge of government intervention in markets and how this may unintentionally lead to a decrease in the efficiency of resource allocation is part of the key knowledge in the study design. Students were required to describe a situation where government intervention failed to improve the allocation of resources or actually made the allocation of resources less efficient when compared to the free (unregulated) market outcome.

Students used a range of appropriate examples of government intervention in response to this question. These included the implementation of the National Broadband Network, the setting of price floors/ceilings such as the minimum wage, energy policies, protectionist policies such as the use of tariffs, subsidies, unfair dismissal laws, and housing market policies such as negative gearing and first home buyer grants.

Many students did not score full marks on this question, and this was often because the student did not make the final link to reduced efficiency. They were able to tell a story about an unintended consequence of government intervention, but then made no explicit link to a decrease in a type of efficiency, thus not completing all the requirements of the question.

A popular example selected by students was the setting of the minimum wage (a price floor). Higher-scoring responses described how the government intervention was implemented and then explained one way it unintentionally led to a decrease in resource allocation.

Question 1d.

Marks	0	1	2	3	Average
%	2	12	35	50	2.4

Most students responded well to this question and were able to explain how the selected policy was likely to influence aggregate supply and the goal of strong and sustainable economic growth.

The following is an example of a possible response.

An increase in spending on training and education is designed to improve the quality of labour resources. Examples of these policies included the Youth Jobs PaTH program in the 2016–2017 Budget and the $1.5 billion Skilling Australians Fund in the 2017–2018 Budget. Increasing spending on training and education aims to improve the skills of current and future members of the labour force, which in turn raises average labour productivity levels in the economy and increases the nation's aggregate supply or productive capacity. By increasing aggregate supply and productive capacity, this will likely reduce average production costs thus boosting the willingness and ability of producers to supply. It will also mean that the economy is able to achieve a higher rate of economic growth without a build-up of inflationary pressure, thereby increasing the economy's ability to achieve strong and sustainable economic growth.

Question 2a.

Marks	0	1	2	3	Average
%	2	4	13	81	2.7

The construction and interpretation of demand and supply diagrams was a new skill included in the current study design, and students tackled the whole of Question 2 with confidence. More than 80 per cent of students scored full marks for the construction of the required demand and supply curve diagram in Question 2a. Some students missed out on marks because they did not fully and accurately label their diagrams.

The following is an example of a possible response. This response also includes the answer to Question 2c., as students were asked to show the adjustment to the market conditions on the diagram that they constructed in Question 2a.
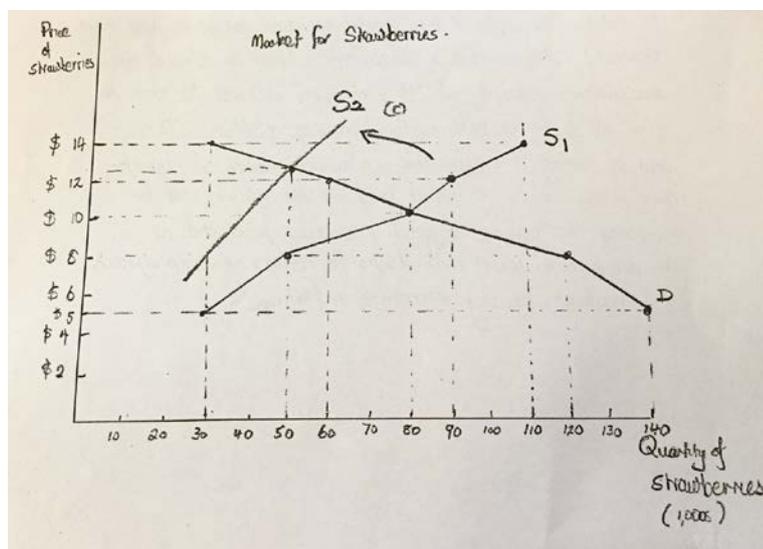
Question 2b.

Marks	0	1	2	Average
%	2	12	86	**1.9**

Most students were awarded full marks for this question. In order to score full marks it was expected that students would make the following points:

- the equilibrium price is $10 per punnet
- the quantity traded is 80 000 punnets of strawberries
- the equilibrium is defined as a situation in the market where the amount supplied is equal to the amount demanded and there is no shortage or surplus.

Question 2c.

Marks	0	1	2	Average
%	9	7	83	**1.8**

This question was handled well by most students. The correct location of the new supply curve S2 is marked on the diagram given for Question 2a., above.

Question 2d.

Marks	0	1	2	Average
%	7	30	63	**1.6**

While most students could show the movement that occurred in the supply curve in Question 2c. some struggled to adequately explain the adjustment to the equilibrium price and quantity.

The following is an example of a possible response.

The unfavourable supply-side conditions (due to a period of unseasonally cold weather) lead to a decrease in the supply of strawberries at each and every price level (shown as a shift of the whole supply curve to the left). At the original equilibrium price of $10 per punnet a shortage occurs where the quantity supplied is less than the quantity demanded. This places upward pressure on the price, resulting in a contraction in the quantity demanded and an expansion in the quantity supplied. In time, the market will come to rest at a new higher equilibrium price and lower quantity traded (approximately $12.50 on the sketched graph).

Question 3a.

Marks	0	1	2	3	4	Average
%	20	19	20	19	21	**2.1**

Students were asked to describe the 2016–2017 performance of the Australian economy in terms of jobs and growth. The phrase 'jobs and growth' was used as a mantra by the government and was taken directly from the Treasurer's budget speech in 2016–2017, and this term was also used in the framing of the Budget in 2017–2018.

Students needed to recognise that this question was asking about the 2016–2017 performance of the Australian economy in terms of the economy's ability to create employment (jobs) and achieve the macroeconomic goal of full employment, and increase economic growth and achieve the macroeconomic goal of strong and sustainable economic growth.

Many students struggled to score high marks for this question. It appeared that a large number of students had not developed a full understanding related to the performance of the Australian economy over the past two years in terms of the macroeconomic goals (a requirement specified in

the study design). Very few students were able to describe the trends related to employment and growth or use any data or statistics to support their description. Students who were able to do this scored the highest marks.

Other students appeared to misinterpret the question and described how budgetary policy influenced jobs and growth, rather than understanding that the question required them to describe the performance of the economy 2016–2017 in terms of jobs and growth.

The following is an example of a possible response.

Full employment is a government macroeconomic goal whereby all people who want a job would be able to obtain one. This might occur when cyclical unemployment is zero or the lowest rate that can be achieved without causing inflation. Some economists suggest that this might be approximately 5%. In terms of jobs, the 2016 and 2017 performance would appear positive as there was an increase in the number of jobs created, with unemployment trending downwards from approximately 5.8% to 5.5% (Sept. 2017). While there have been a number of jobs created in 2016 and 2017, a number of these have been part-time jobs with many workers wishing to work more hours. The underemployment rate peaked at approximately 8.7%, which signals that there is in fact a fair amount of spare capacity in the labour market that makes our performance in terms of jobs (job creation) less positive. In terms of rates of economic growth, it would be reasonable to suggest that the Australian economy has been performing below expectations across 2016 and 2017. Over this period real GDP has hovered around 2.5%, with economists reporting this as a direct consequence of the end of the mining investment boom. Although real GDP dipped to 1.9% in 2016–2017 as Australia recorded a negative quarter of growth in September 2016 (Sept. quarter real GDP of –0.4%). This is below the unofficial target for strong and sustainable economic growth, which is 3–3.5% or even up to 4% per annum.

Question 3b.

Marks	0	1	2	3	4	Average
%	4	16	28	28	23	2.5

Students needed to ensure that their explanation focused on how one of the aggregate supply policies listed might be implemented to increase jobs (employment) and growth. Aggregate supply policies are those implemented to boost the willingness and/or the ability of producers to expand output of goods and services in the Australian economy. Policies targeted at the willingness to produce are generally focused on productivity improvements and minimisation of cost factors to enhance profitability for producers (for example, taxation reform aimed at lowering company tax). Policies targeted to improve the ability to produce are generally focused on boosting the quantity and/or the quality of productive resources available to producers (for example, through immigration or welfare reforms).

Many students were unable to explain how their selected aggregate supply policy might increase employment and growth from the supply side and instead turned their explanation into a demand-side argument. They did not demonstrate that they understood how these policies are designed to operate to increase the willingness and ability of producers to produce through, for example, improving the quality or quantity of the factors of production and/or lowering the costs of production, thus expanding aggregate supply.

Question 3c.

Marks	0	1	2	3	4	Average
%	7	16	30	29	18	2.4

Students struggled with the concept of strengths and weaknesses related to a specific aggregate supply policy and many simply focused on how the policy operated, which did not answer the question. Higher-scoring answers outlined a strength and a weakness that pertained specifically to the selected policy.

The following is an example of a possible response that uses taxation reform as the selected policy.

Taxation reform such as the lowering of company tax rates is part of the government's budgetary policy. The strength of such a policy is that it can target particular areas of the economy in order to specifically focus on the achievement of its economic goals. A cut in the company tax rate could provide a boost to investment and also attract more foreign investment to Australia, thereby increasing aggregate demand and economic growth. A lower company tax rate would also lower costs of production for firms and increase their willingness and ability to supply, thereby increasing aggregate supply and allow for higher rates of economic growth. A weakness might be that in an era of fiscal consolidation a reduction in company tax would contribute to reduced government revenue, thereby adding to the size of the budget deficit.

The following is an example of a possible response that uses immigration policy as the selected policy.

The government has used immigration policy to bring in skilled migrants, which increases the quality and quantity of labour resources in the Australian economy. A strength of this policy is that the government is able to target areas of need in the economy where there are skills shortages. In so doing, a benefit to the Australian economy is that these migrants arrive 'job ready' and their country has borne the cost of the education and training of these workers. A weakness of immigration policy is that the government has used the policy as a 'quick fix' rather than invest in the education, training and retraining of Australians, such as the structurally unemployed, which would assist these job seekers to find employment and lower Australia's unemployment rate.

Question 3d.

Marks	0	1	2	3	4	5	6	7	8	Average
%	19	8	10	11	15	9	11	8	8	3.6

This question required students to demonstrate their knowledge of how the aggregate demand policies of budgetary policy and monetary policy had operated in 2016–2017 to influence jobs (and the goal of full employment) and growth (and the goal of strong and sustainable economic growth). High-scoring responses demonstrated a detailed knowledge of aggregate demand policies implemented over 2016–2017 and tied them to the creation of jobs (lower unemployment) and the relatively subdued rates of economic growth.

Many students were not able to select aggregate demand policies – that is, budgetary and monetary policies – and demonstrate how these policies have operated over 2016–2017 to influence jobs and growth. Very few students selected monetary policy as an aggregate demand policy. Even when students selected aspects of budgetary policy, many referred to aggregate supply influences of budgetary policy rather than aggregate demand influences.

Generally, over the past two years monetary policy has focused on immediate and short-term support of demand and macroeconomic variables including the rate of economic and employment growth (while inflation is considered under control). The government has focused budgetary policy

upon the intermediate to longer-term economic prosperity of the nation in order to create a climate that is conducive to higher rates of economic growth and job creation.

Answers could have included this sort of explanation in relation to monetary policy. Monetary policy has been very expansionary over the past two years, with the cash interest rate at a historic low of 1.5% (well below what is considered to be a neutral monetary stance of a cash interest rate of 3.5%). Low interest rates act to stimulate aggregate demand (AD) through the five transmission mechanisms/channels to boost the relevant components of AD. For example, the lower cash rate has flowed through to variable interest rates on home loans and many households now have more discretionary income. Households may therefore choose to increase consumption expenditure. When a component of aggregate demand (in this case, private consumption expenditure) increases, producers have a greater incentive to increase production (growth in GDP) and in so doing may prompt the businesses to hire more workers (jobs increase). However, despite record low interest rates, growth has been sluggish, with many households preferring to pay off debt rather than increase their spending. While some jobs have been created and unemployment levels have trended down from around 5.8% to 5.5%, jobs that have been added have tended to be part-time, so underemployment remains an issue in the economy.

An explanation related to budgetary policy may have included the following points. The 2016–2017 Budget sought to strengthen Australia's fiscal position as the economy transitions from the benefits of the past mining boom to a platform of broader-based growth. The government stood firm on its goal of achieving a return to budget surplus in the next five years with a projected decline in the size of the budget deficit. Therefore the 2016–2017 Budget was considered to be mildly contractionary given the reduction in the size of the budget deficit compared to the previous year. This is because the federal government was injecting a smaller level of funds into the economy, relative to leakages collected from taxation and other revenue sources compared to the previous year.

While the size of the budget deficit in 2017–2018 was forecast to be smaller than in 2016–2017, which would generally indicate a mildly contractionary budget stance, the size of the structural budget deficit in 2017–2018 has increased thereby indicating that the 2017–2018 Budget is predicted to have a mildly expansionary effect on the economy. The discretionary budget changes, such as the increased expenditure on infrastructure projects, are policies designed to create jobs, which increases aggregate demand and economic growth (and over time improves productive capacity and aggregate supply as well) thereby increasing the willingness and ability of businesses to supply and thus increasing economic growth and job creation.

Question 3e.

Marks	0	1	2	3	4	5	6	7	8	Average
%	8	4	5	6	11	14	20	16	16	**5.1**

Many students answered this question well. To score high marks, responses needed to explicitly evaluate the strengths and weaknesses of budgetary and monetary policy in achieving increased jobs and growth – not just list the strengths and weaknesses without evaluating them. It is important that students consider the command terms within a question and ensure that their answer responds to the requirements of the question based on these. In this question it was expected that the student evaluate the strengths and weaknesses in terms of achieving increased jobs and growth; many students did not frame their answers in this way and therefore were unable to score high marks.

Higher-scoring responses also used examples to illustrate their identified strengths and weaknesses, rather than just listing generic strengths and weaknesses.

Lower-scoring responses demonstrated some confusion about the strengths and weaknesses of each policy, for example, saying that the impact of monetary policy is 'instant' and the impact of budgetary policy is 'really slow'.

Question 4a.

Marks	0	1	2	3	Average
%	5	16	42	36	2.1

Responses to this question suggested that many students were not aware that the RBA is as concerned by too-low inflation as it is by too-high inflation. The 'target band' idea as specified in the low inflation goal seemed to be a concept that was not fully understood by many students.

Lower-scoring responses to this question also included those that:

- did not include a definition of the goal of low inflation (price stability)
- did not keep their assessment to the correct time period of 2016–2017, as specified in the question
- did not answer the question and were unable to assess the extent to which the goal was achieved when the rate was below the target as specified in the goal of low inflation
- ignored that inflation was too low – many saying this was 'good' – and instead focused on factors causing inflation to rise.

The following is an example of a possible response.

The goal of low inflation (price stability) is to achieve a sustained increase in the general level of prices of between 2% and 3% (as measured by the Consumer Price Index [CPI]) on average over time. This is a rate of inflation that is sufficiently low that it does not materially distort economic decisions in the community but is a rate that supports the long-term growth of the economy. For most of 2016–2017 the inflation rate was below 2%, although at the beginning of 2017 it hit the bottom end of the target for a short period. This means that inflation was well contained being between 1% and 2% for the period with the target of 2–3% not achieved. This has meant that the RBA's priority has been re-inflating the economy by cutting interest rates in order to stimulate aggregate demand, economic growth and inflation.

Question 4b.

Marks	0	1	2	Average
%	29	24	47	1.2

High-scoring responses chose a factor that might have influenced the rate of inflation over the 2016–2017 period, indicating that the student had good current knowledge of the performance of the economy. These factors included slow growth in real wages, high levels of household debt constraining growth in household spending, relatively low levels of consumer confidence and the relatively high exchange rate (appreciation of Australian dollar decreasing costs of production for businesses).

Some lower-scoring responses referred to prices falling. Students need to note that any inflation (that is, CPI above 0%) means prices are rising. Also, many students did not select an actual economic factor – for example, they chose 'unemployment', which is not an economic factor.

Question 4c.

Marks	0	1	2	3	4	Average
%	20	13	22	28	17	**2.1**

Many students did not demonstrate detailed knowledge of the monetary policy stance and focus over the past two years. Few students referred to the RBA charter and the other goals of the RBA beyond low inflation/price stability.

The following is an example of a possible response.

The low inflation figure (below the target as discussed in part 4a.) does cause the RBA some concern (especially when it got close to 1% and there was some fear that deflation might result). The RBA lowered the cash rate in May and August 2016 with the combined aim of elevating the inflation rate and trying to achieve its other economic goals (as set out in its charter) of full employment and strong and sustainable economic growth. The stance of monetary policy then over 2016–2017 has been expansionary and the focus was to achieve their targeted inflation rate (between 2% and 3% over time) and boost economic growth (which over this period has been below the hoped for levels) and employment (all be it that unemployment has improved a little but is still above expectations and as well underemployment is considered too high).

Question 5a.

Marks	0	1	2	Average
%	29	30	41	**1.1**

Most students demonstrated an understanding of the graph and provided an appropriate economic factor to explain the trend. The factors most commonly selected were the improvement in Australia's terms of trade, improving rates of world economic growth and the considerable fall of the exchange rate since the height of the mining boom. However, many lower-scoring responses tended to confuse the current account deficit with a budget deficit and/or argued that the government was responsible for paying the deficit.

The following is an example of a possible response.

The graph indicates that the current account balance improved over the 2016–2017 period, falling from a deficit of over 6% of Gross Domestic Product (GDP) to just below 1% of GDP. This is likely to have been caused by the improvement in the terms of trade. When the terms of trade improves (a favourable movement in the terms of trade) as it has done over the course of 2017 each export (for example iron ore, coal) sold receives a higher price. Therefore, a given quantity of exports sold will generate more revenue. Therefore, export credits as recorded in the balance of trade are likely to increase. When export credits increase the balance of trade improves, which means that the overall current account deficit is likely to become smaller, i.e. from –6.0% of GDP to about –1.0% of GDP as shown in the graph.

Question 5b.

Marks	0	1	2	3	4	5	6	Average
%	12	7	11	15	19	18	17	**3.5**

This question was generally completed well and students demonstrated a very good knowledge of trade liberalisation and its implications for two of Australia's domestic macroeconomic goals. The highest-scoring responses included an accurate definition of trade liberalisation and explained how it would likely affect two of Australia's domestic macroeconomic goals.

Students were required to select any two of Australia's domestic macroeconomic goals (that is, low inflation and/or full employment and/or strong and sustainable economic growth) as specified in the study design. Some students appeared to be working from the previous study design, referring to external stability, equity or living standards as macroeconomic goals.

Many students did not accurately explain the effects by outlining whether the effect had a short-term or long-term impact, which often resulted in the answer not being awarded higher marks.

Other lower-scoring responses made the assumption that by reducing tariffs and increasing competition in the market, Australia automatically becomes more efficient and competitive and can straightaway sell more exports with jobs simply being created as a result. Students need to fully develop their explanations and demonstrate the economic links in order to score high marks.

The following points were found in high-scoring responses.

Trade liberalisation is the removal of protectionist measures by governments (for example, quotas, tariffs, subsidies) to increase the free movement and exchange of goods and services. It also includes free trade agreements and reduction in industry assistance.

Goal: low inflation

Trade liberalisation has contributed to Australia's low inflation climate in a number of ways:

- When tariffs are reduced or removed, the price of imported goods is reduced.
- This exposes Australian businesses to more intense price competition from foreign goods. It forces import competing firms to improve productivity (more output from inputs) to lower average costs of production to be able to compete on price – that is, be internationally competitive.
- Additionally it has allowed cheaper access to imported capital equipment, which reduces costs of production and bears down on cost inflationary pressures.

Goal: full employment

- Local businesses that compete with imports are forced to become more competitive as imports are now cheaper (following, for example, a reduction in tariffs) than locally produced goods. This can cause structural unemployment in the short term as some businesses will fail due to their inability to compete with the lower prices. Also the removal of subsidies such as those made to the Australian car manufacturers meant that producing Australian cars was no longer viable. The closure of the car manufacturing plants has resulted in an increase in those who are structurally unemployed and as a result unemployment increases.
- Trade liberalisation has worked to establish a low inflation climate, which has been conducive to business investment and expansion. In such a climate businesses are able to budget for profit with greater certainty and the resultant business expansion brings with it more employment opportunities.
- In the longer term, employment should increase as economic growth increases and local businesses become more internationally competitive with more opportunities for sales in export markets. This leads to a need for additional labour resources – helping to achieve full employment.

Goal: strong and sustainable economic growth

- When tariffs are reduced or removed, the price of imported goods is reduced.
- In the short term, some local firms close down because of their inability to compete with cheap imports leading to lower rates of economic growth.
- However, lower tariffs on inputs in the production process, such as on capital equipment, leads to a reduction in the costs of production and may increase the international competitiveness of Australian businesses thus increasing economic growth.

- In the longer term, local firms, for example, in import competing industries will restructure operations to compete with foreign-made goods (imports) and resources reallocated from less efficient industries to most efficient industries – that is, where Australia has a comparative cost advantage – thus leading to increased economic growth.