

2018 VCE Economics written examination report

General comments

Students generally performed well in Section A, the multiple-choice section of the examination. The majority of students also attempted all questions in Section B, which indicates that most students managed their time effectively.

Many responses were of high quality. These responses answered questions both directly and precisely and used economics language and terminology accurately. Many high-quality answers also showed, where appropriate, current knowledge of the performance of the Australian economy.

The main areas identified for potential improvement by students were in demonstrating clearer and deeper understanding of each of the following:

- the distinction between a budget deficit and a current account deficit
- the meaning of market failure and how the existence of externalities and asymmetric information may contribute to market failure
- how and why the government may respond to market failure
- the meaning and differences between the various types of efficiencies, such as allocative efficiency and dynamic efficiency
- the transmission mechanisms of monetary policy and their influence on the level of aggregate demand, including savings and investment, cash flow, availability of credit, exchange rate movements and asset prices
- evaluating the strengths and weaknesses of aggregate demand policies in achieving the Australian Government's domestic macroeconomic goals
- how the following aspects of budgetary policy are designed to influence aggregate supply and the achievement of domestic macroeconomic goals:
 - spending on training and education
 - research and development grants
 - subsidies
- how welfare and tax reform policies are designed to influence aggregate supply
- the effect of immigration policies on the labour market and on aggregate supply and the way in which this influences the achievement of domestic macroeconomic goals
- the strengths and weaknesses of using aggregate supply policies to achieve the Australian Government's domestic macroeconomic goals.

Specific information

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

This report provides sample answers or an indication of what the 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	4	8	86	2	
2	47	25	3	25	Expansionary monetary policy is one where the setting of the target cash rate is low enough to be stimulating aggregate demand. Stimulating aggregate demand is likely to cause a rise in the rate of economic growth, thereby increasing the demand for labour. If more people are working there is likely to be a reduction in the need to pay unemployment benefits, thereby causing a decrease in welfare payments.
3	69	8	22	0	
4	2	3	90	5	
5	6	33	7	54	
6	1	0	22	77	
7	7	85	3	5	
8	9	90	1	1	
9	2	2	93	3	
10	96	1	1	2	
11	1	2	6	91	
12	12	14	11	64	
13	9	4	5	83	
14	44	26	9	20	If there were an increase in inflation rates in the United States (US) it is likely that there would be an increase in US interest rates to bear down on the inflationary pressure. By raising US interest rates, it is likely to also mean that investors from around the world would be attracted to the higher interest rate returns on offer in the US. Therefore, there might be capital outflow from Australia, thus leading to a depreciation of the Australian dollar.
15	6	6	66	22	

Section B – Written responses

Question 1a.

Marks	0	1	2	3	Average
%	9	20	48	23	1.9

Most students were able to indicate an understanding of both allocative and dynamic efficiency by providing accurate definitions of these terms. However, many students did not complete the question by providing a distinguishing feature of each type of efficiency. This meant that many students could not score full marks.

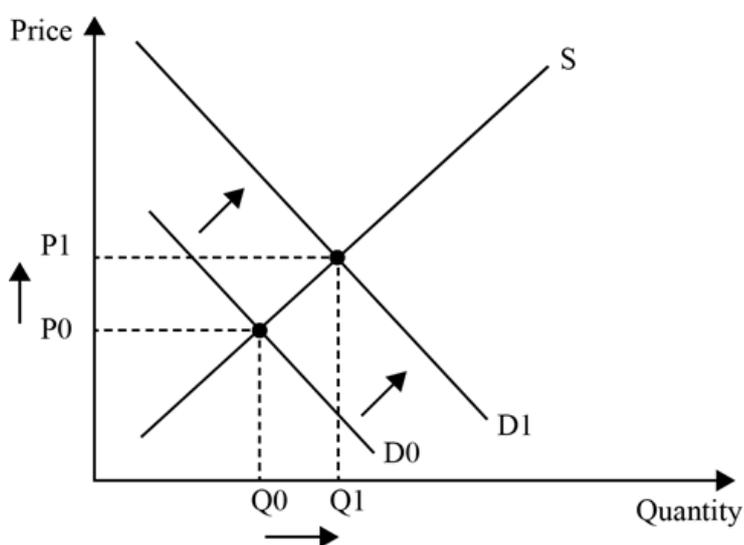
The following is an example of a possible response.

Allocative efficiency occurs when resources are used to produce the combination of goods and services that best satisfies society's needs and wants, so that society's wellbeing is maximised. Dynamic efficiency refers to the speed at which resources are reallocated from one area of production to another in response to a change in consumer preferences or tastes.

Dynamic efficiency promotes the achievement of allocative efficiency and it involves improving allocative efficiency over time.

Question 1b.

Marks	0	1	2	3	4	Average
%	8	7	9	20	57	3.1



The majority of students demonstrated a very good understanding of complements. The highest-scoring responses provided a clear definition and an example to illustrate the explanation.

The following is an example of a possible response.

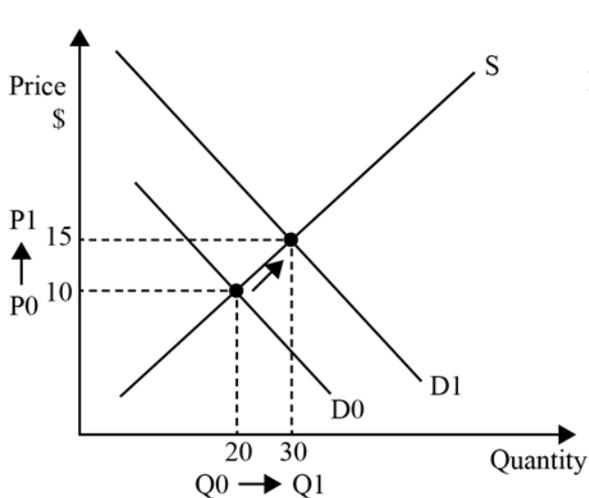
A complementary good is a good that is used in conjunction or together with another good, that is the goods are generally consumed together, for example, bread and butter, tea and sugar, strawberries and cream.

A change in the price of a complementary good is a non-price demand factor and, therefore, will cause a shift of the entire demand curve for the good for which it is a complement. A decrease in the price of a complement (butter) may lead to an increase in the demand for a good (bread). An increase in demand will shift the demand curve to the right (D_0 to D_1). The initial increase in

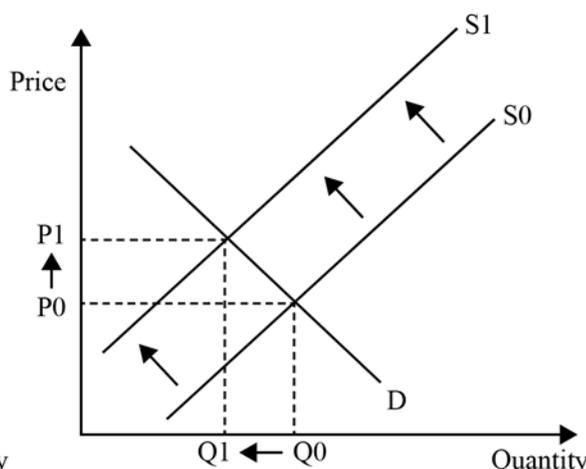
demand results in a shortage at the original price. Suppliers may increase the price and/or customers compete for the remaining available stock. As the price rises (P_0 to P_1), producers have a profit incentive to produce more, resulting in an expansion in supply (Q_0 to Q_1) and a higher equilibrium price (P_1) and quantity traded (Q_1).

Question 1c.

Marks	0	1	2	3	4	Average
%	5	7	17	33	39	3



movement along supply curve as a result of an increase in price from P_0 to P_1



shift in supply curve caused by a change in the non-price determinants of supply

This question was generally well answered by the majority of students. In order to achieve full marks, however, students were expected to link the movement along the supply curve with changes in price.

The following is an example of a possible response.

A movement along a supply curve can occur as a result of a change in price. When there is a change in the price of a good, for example, the price increases from \$10 to \$15, this will result in suppliers being more willing to supply (profit incentive) and there will be an upward movement along the supply curve (expansion in supply) – quantity supplied moves from 20 to 30.

A shift of the supply curve results from any factor other than price, which affects supply. For example, less favourable climatic conditions result in a shift of the supply curve from S_0 to S_1 , in this case to the left as less will be supplied at each given price.

Therefore, a change in price of the good results in a movement along the supply curve, while a change in a factor other than price results in a shift of the supply curve.

Question 1d.

Marks	0	1	2	3	Average
%	9	19	37	35	2

Many students were too simplistic or brief in their explanations of how the existence of externalities or asymmetric information results in market failure. Many students were unable to explain that when externalities or asymmetric information exists it is necessary to intervene in the market to change the allocation of resources so that wellbeing is improved.

In many cases, students used simplistic and general language rather than specific economics language. For example, students wrote in their explanation of the ideas of markets not working efficiently, that this caused ‘bad outcomes for other people’ or ‘negative effects on other people’ rather than using economics language such as ‘costs to third parties’ and ‘allocation of resources that does not maximise welfare’ because of ‘overproduction/overconsumption’ of goods and services that produce negative externalities. This lack of attention to precise language and accurate terminology meant that a number of students could not score full marks for this question.

Students who chose to explain externalities could choose between an explanation related to a negative externality or to a positive externality. One source of market failure is externalities. An externality arises when the production or consumption of a good or service has an effect, whether positive (confers a benefit) or negative (imposes a cost), upon a third party.

Externalities affect third parties – that is, individuals or groups outside the market. In other words, those who are not involved in, or a part of, the market that causes them. Because those involved in the market do not take into account the externalities that arise from their actions, the outcome is seen as inefficient from society’s standpoint.

The following is an example of a possible response using a negative externality.

An example of a negative externality is carbon dioxide emissions from production of electricity from coal-fired power stations. This is a factor resulting in climate change. The costs of this negative externality, which results in climate change, is not internalised by producers. Therefore, an over allocation of resources towards the use of coal in electricity production occurred with the costs associated with this production not born by producers or consumers.

The following is an example of a possible response using asymmetric information.

Asymmetric information occurs when one party to an economic transaction possesses greater material knowledge than the other party; that is, this type of market failure exists where one party has greater information than the other in an economic exchange. For example, in the used car market, buyers may not be privy to the same information as the sellers, as the seller knows far more about the history of the car than the buyer. The seller may well be selling the car because of a fault that will soon require fixing. Without a very thorough check of the car by the buyer, the buyer will likely be unaware that the used car may break down soon after it is purchased, which will require some expensive maintenance. The buyer may then pay a higher price for the used car than they otherwise would have if they had known about the fault. This means asymmetric information in the used car market leads to an overallocation of resources to the used car market and that the market fails to deliver outcomes that are in the best interests of society.

Question 1e.

Marks	0	1	2	3	Average
%	13	19	37	30	1.9

Higher-scoring responses to this question discussed addressing externalities. Many of the students who selected asymmetric information (in Question 1d.) started with the idea of government legislation to force suppliers to reveal more information about the product, but did not seem to know how to link this back to addressing market failure and changing resource allocation so wellbeing is improved.

The government can intervene in the market through the implementation of a range of policies, including indirect taxes, subsidies, advertising, regulation and direct provision in order to achieve an efficient (or socially optimal) allocation of resources.

Negative externalities negatively impact society’s wellbeing; therefore, the government seeks to discourage them. Carbon dioxide emissions from the production of electricity from coal-fired power

stations are considered a factor resulting in climate change with the costs of this negative externality not internalised by producers. The Australian Government briefly implemented a carbon tax on producers designed to internalise the external costs associated with the use of fossil fuels. This increased the costs of production for industries using fossil fuels and influenced a change in the allocation of resources as electricity prices increased and consumption decreased.

Government action for asymmetric information to protect consumers from purchasing poor-quality used cars include mandatory three-month warranties. This protects consumers from being sold a poor-quality used car.

Question 2a.

Marks	0	1	2	3	Average
%	20	31	33	16	1.5

This proved to be a challenging question for students. Students focused on how monetary policy could be used to combat low wages, which was incorrect. Rather, students should have described how the existence of low wages growth will encourage the Reserve Bank of Australia (RBA) to maintain an expansionary stance since inflation is under control.

High-scoring answers included the following points:

- The last adjustment to the cash interest rate was in August 2016, when it was reduced to 1.5%. In determining monetary policy, the RBA's objectives are to maintain price stability, full employment, and the economic prosperity and welfare of the Australian people. To achieve these statutory objectives, the RBA has an 'inflation target' and seeks to keep consumer price inflation in the economy to 2–3 per cent, on average, over the medium term/over time. Given that in 2017 and 2018 inflation has been contained (either below the target or in the targeted range), the RBA has been focused on creating conditions to encourage higher levels of economic and employment growth – an accommodative/expansionary stance. The cash rate has remained at very low levels.
- Low wages growth reduces demand and cost inflationary pressures. This will support the achievement of a continued low inflation environment. Therefore, there will be lower inflationary pressures and less pressure to raise interest rates. Its influence on monetary policy (the manipulation of cash interest rates by the RBA to achieve the goal of low inflation) is that it has been a factor in allowing the RBA to leave the cash rate at 1.5%, a historic low during 2017 and 2018. The RBA has then been able to focus on creating an environment that stimulates economic and employment growth (an accommodative/expansionary stance), focusing on its other objectives as stated in its charter.

Question 2b.

Marks	0	1	2	3	4	5	6	7	8	Average
%	18	6	6	6	7	7	13	21	14	4.5

Most students understood that if the RBA raised the cash rate from 1.50% to 2.00%, this would represent a tightening of monetary policy. Some students rightfully pointed out that monetary policy would still be considered to be expansionary or accommodative given that a cash rate of 2.00% is still below what is deemed to be monetary policy neutrality of 3.50%.

The quality of responses varied depending on the selection of transmission mechanisms.

For example, a number of students did not seem to understand that the exchange rate channel operates to decrease aggregate demand when there is an appreciation of the Australian dollar (AUD). They were focused on the aggregate supply effect being positive due to decreased costs of imported inputs, without understanding that the negative aggregate demand effect, via the net

exports component, will likely outweigh the positive aggregate supply effect. Furthermore, if aggregate demand is falling, why will producers increase output?

A number of students did not understand the asset price channel, arguing that increased interest rates will raise the price of housing, thereby increasing aggregate demand.

The highest-scoring answers made the following points:

- If the RBA raised the cash rate this would signal a tightening in monetary policy (a move to a more contractionary stance). This would suggest that the RBA was concerned about the emergence of some inflationary pressures and wished to raise the interest rate to curb these pressures. The aim would be to 'slow down' aggregate demand pressures and the rate of economic growth (although a 2% cash rate is still at a relatively low level).
- The increase in the cash rate will affect the level of aggregate demand and the rate of economic growth through any one of the five transmission mechanisms. (Students could have selected any two of the following transmission mechanisms).
 - Cost of credit channel: The cost of credit channel is the transmission mechanism through which changes in interest rates affect the cost of credit and therefore the wider economy. For example, an increase in the cash rate causes interest rates to rise, and therefore it costs more for businesses and households to borrow. This should discourage households from borrowing and encourage them to save more. It also discourages businesses from borrowing to invest. Both of these effects reduce aggregate demand and inflationary pressures. As before, the reverse holds true. A decrease in the cash rate causes interest rates to fall, reducing the cost of borrowing for households and businesses. This should encourage households to borrow and discourage them from saving. It also provides businesses with the incentive to borrow to fund planned investments. Both of these effects should result in higher levels of aggregate demand, production and employment.
 - Cash flow channel: The cash flow channel is the mechanism through which cash rate and interest rate changes affect the level of repayments on loans for those with existing variable rate loans (such as mortgages, personal loans, credit cards and business investment loans). For example, when monetary policy is tightened, borrowers experience a decrease in the amount of discretionary income available as they allocate more of their disposable income to the servicing of existing loans. This reduction in cash flows affects the willingness and ability of both households and businesses to spend (on consumption and investment), and thus reduce aggregate demand and inflationary pressures. The reverse holds true. That is, when monetary policy is loosened, borrowers experience an increase in the amount of discretionary income available as they allocate less of their disposable income to servicing existing loans. This improvement in cash flows raises the willingness and ability of both households and businesses to spend (on consumption and investment), resulting in higher levels of aggregate demand, production and employment.
 - Exchange rate channel: The exchange rate channel is the mechanism through which changes in monetary policy (the cash rate) in Australia impact the value of the Australian dollar (the exchange rate). For example, when the RBA tightens monetary policy by raising the cash rate (or when interest rates are simply higher relative to overseas rates), this often results in a net inflow of capital into Australia, as overseas investors seek the relatively better returns available in Australia. This causes an increase in demand for the Australian dollar relative to supply, and the Australian dollar appreciates in value. As the Australian dollar appreciates, the competitiveness of our external sector declines, thereby reducing demand for our exports and increasing demand for imports. This should result in a reduction in the net exports (exports X – imports M) component of aggregate demand, thereby decreasing aggregate demand and the rate of economic growth.
 - Availability of credit channel: The availability of credit channel is the transmission channel through which changes in monetary policy affect the ease or difficulty for households and

businesses to access loans. For example, when monetary policy is tightened, fewer households and businesses meet the eligibility criteria for borrowing from banks. This is because fewer applicants are likely to be able to meet the repayment requirements associated with higher interest rates on loans. This reduces the availability of credit and the volume of loans made, thus reducing the consumption and investment components of aggregate demand as well as inflationary pressures. The reverse also holds true. That is, when monetary policy is loosened, more households and businesses satisfy the eligibility criteria for borrowing from banks. This is because more applicants are likely to be able to make the repayments associated with lower interest rates on loans. This improves the availability of credit and the volume of loans made, thus increasing the consumption and investment components of aggregate demand and therefore, production and employment.

- Asset price channel: The asset price channel is the transmission channel that is responsible for the effects induced by monetary policy decisions that affect the prices of assets. For example, when monetary policy is tightened, the demand for major assets like housing and shares should decrease. This is likely to result in a decrease in the price of these assets. As these prices fall, consumers may experience a negative ‘wealth effect’, whereby they feel relatively poorer and less able to spend (on consumption and investment) because of their decreased ‘paper’ wealth (that is, how much assets can be sold for). This decreases aggregate demand and economic growth. Looser monetary policy has the opposite effect, whereby rising asset prices and a heightened ‘wealth effect’ encourage spending, production and employment.
- Lower levels of aggregate demand would result in a build-up of unsold stock signalling to businesses to cut production, resulting in a slowdown in the rate of economic growth.

Question 2c.

Marks	0	1	2	3	Average
%	15	18	30	36	1.9

This question was reasonably well answered. Many students were able to identify either that the impact lag leads to the risk that monetary policy can start to operate pro-cyclically, or that the fact the RBA does not directly control interest rates leads to the risk that banks will not pass on a full rate cut, or can begin to increase interest rates even when the RBA keeps the cash rate very low (as was happening at the time of the examination).

Many students were able to state a weakness, such as that monetary policy is a blunt instrument, but were unable to outline what the weakness means in terms of increasing aggregate demand and the rate of economic growth.

Question 3a.

Marks	0	1	2	3	Average
%	25	29	23	23	1.5

While there were some very strong answers to this question, some students did not use the provided statistics in the graph in their answer when identifying the trend and did not correctly understand what is meant by the word ‘factor’. Furthermore, some students discussed budget deficits, showing that students struggled with understanding the differences between budget deficits and current account deficits.

The following references to the graph and to one factor were expected in response to the question:

- Trend: The trade surplus moved from a surplus to a tiny deficit and the current account deficit increased as a percentage of GDP in 2017.

Factor: appreciation of the AUD

- Trend: The trade surplus increased and the current account deficit decreased as a percentage of GDP in 2018.

Any one of these factors:

- depreciation of the AUD
- stronger terms of trade (rising commodity prices)
- stronger world economic growth.

Question 3b.

Marks	0	1	2	3	4	Average
%	9	10	19	29	34	2.7

While this question was generally handled well, a number of challenges were apparent:

- Students needed to explain all the links rather than just assuming that one thing would follow the next – for example, that removing tariffs would ‘automatically’ improve competitiveness. How would removing tariffs improve competitiveness? What steps lead to this outcome?
- Students should have demonstrated their understanding that trade liberalisation has the effect of exposing local producers to international competition, forcing them to improve their productivity or efficiency in allocation of resources (i.e. as per comparative advantage).
- A small number of students indicated a lack of understanding by incorrectly saying that the tariffs Australia sets are imposed on exporters.
- Students need to be reminded to answer all parts of the question. Some students did not discuss how trade liberalisation is likely to affect both international competitiveness and living standards, and thus these students could not score full marks.

Question 3c.

Marks	0	1	2	3	4	Average
%	8	20	31	34	7	2.1

In general terms, students understood the effects of immigration on the labour market and aggregate supply, and they were able to argue the potential negative implications for a decrease in the immigration level. However, very few students picked up on the subtle implications of a slower rate of growth in immigration, as most students looked at a decrease in immigration.

The following are examples of possible responses to this question.

- If immigration targets are reduced to 100 000 then the growth in labour supply will slow down and be reduced. This may create an imbalance between the demand for labour and the supply of labour in some job areas. The shortage will increase the bargaining power of the existing workforce and make it harder for employers to reject wage increases. For some producers, the reduced level of immigration may make it harder to expand the size of their operations and boost their productive capacity (which in aggregate reduces the ability of firms to meet any increase in potential aggregate demand and with an increase in aggregate supply). They may be willing to expand but cannot find a sufficient quantity of productive labour resources so the growth in aggregate supply grows more slowly.
- Labour market conditions relate to the demand for, and supply of workers for different occupations over time. A cut in the annual intake of immigrants has the potential to cause a ‘tightening’ of labour markets conditions, resulting in shortages of suitably skilled labour. This can place upward pressure on wages and businesses’ costs of production, reducing their willingness and ability to supply and, in turn, the amount of goods and services available for

sale (aggregate supply) in the economy. Alternatively, a reduction in the annual intake of immigrants reduces the quantity of the labour resource available to the business sector in the economy. With reduced access to labour resources, businesses will be less willing and able to supply, negatively affecting the amount of goods and services available for sale (aggregate supply) in the economy.

Question 3d.

Marks	0	1	2	3	Average
%	10	40	23	26	1.7

Students had some difficulty in answering this question. Many tended to discuss how immigration policy linked with the goal of strong and sustainable growth, so their answers more often than not discussed how the policy worked rather than the benefits or strengths of using this approach, which was the focus of the question. Higher-scoring answers tended to focus on immigration policy being able to target skills shortages and on the fact that immigration provides ready-to-work and skilled labour resources and facilitates a low inflationary growth environment, all of which assists in the achievement of strong and sustainable economic growth.

The following are examples of possible responses to this question.

- Immigration policy can target particular sectors, industries or regions where skills shortages exist. This makes it a particularly potent policy option compared to monetary policy, which can only regulate aggregate demand and is incapable of targeting particular sectors, industries or regions. This enables immigration policy to alleviate capacity constraints caused by skills shortages in specific industries, and, in doing so, permits higher rates of economic growth.
- Given that about two-thirds of Australia's annual immigration intake is made up of ready-to-work skilled migrants, the Australian Government does not need to allocate scarce financial resources in an era of 'fiscal consolidation' or 'budget repair' to training programs. This 'frees up' funds for other programs to support the achievement of the macroeconomic goals. Because it is relatively inexpensive to implement, scarce government revenues can be allocated to other programs to support economic growth.

Question 4a.

Marks	0	1	2	3	4	5	6	Average
%	4	4	8	14	21	24	26	4.2

The highest-scoring answers defined the goal, commented on the evident trend and then assessed whether the trend achieved the goal. A number of high-scoring answers not only engaged with the graphs provided, but were able to supplement them with up-to-date data that followed on from the information in the graphs.

The following is an example of a possible response.

The goal of strong and sustainable economic growth is the strongest growth rate possible, consistent with strong employment growth, without inflationary, external or environmental pressures, currently viewed to be an annual growth rate of between 3.0% and 3.5% per annum.

The goal of full employment is a level of employment that is consistent with the goal of economic growth, where cyclical unemployment is minimised. Currently, it is generally viewed that an annual unemployment rate of approximately 5% would mean that the government's full employment goal was achieved.

As shown in the GDP Growth chart, GDP has been increasing – from below annual rate of 2% in 2017 to approximately 2.4% in 2018. In October 2018, the RBA media release indicated GDP now increasing at 3.4% with inflation around 2%, so inflationary pressures still remained under control.

As shown in the Labour market graph, the unemployment rate has been lowered to around 5.5%, as shown in the graph in 2018. Latest figures indicate unemployment to be 5.3% in October 2018, which is getting closer to the government’s goal of full employment. However, there are increasingly high levels of underemployment (above 8%), which suggests that workers would like to be working more hours. This and increasing casualisation of the labour force are considered negatives in assessing whether we can say that the government has achieved full employment.

On the face of it, the government is on track to achieve these goals; however, spare capacity in economy is evident.

Question 4b.

Marks	0	1	2	3	4	Average
%	24	14	19	18	25	2.1

While there were some high-scoring responses, many students struggled with this question. Many students discussed how to move the budget from a deficit to surplus and how the government could increase taxes and reduce expenditure.

Students should have selected one of the following:

- selling bonds to the RBA
- selling bonds to Australian investors
- selling bonds to overseas investors.

Question 4c.

Marks	0	1	2	3	Average
%	35	20	21	23	1.3

Students struggled to meet the requirements of this question. Many students interpreted it as asking how the government will return the budget to surplus, which was not what the question asked. Many answers indicated that students confused a budget deficit and a current account deficit, and discussed the need to run a surplus so that the government can pay off the current account deficit.

Responses that discussed one of the following reasons as a rationale scored highest:

- reducing debt, which is a burden on future generations – bigger debt means bigger interest repayments, which means there is less revenue to be used on other needs such as the building of infrastructure
- credibility with global institutions such as the International Monetary Fund and G20
- desirability of retaining AAA credit rating from agencies such as Moody’s and Standard and Poors – a lower rating is likely to increase borrowing costs
- a strong balance sheet, which provides the government with the flexibility to respond to unanticipated events during times of financial crises or economic shocks (for example, increasing protectionism among developed economies such as the USA is an example of a possible economic shock).

Question 4d.

Marks	0	1	2	3	4	Average
%	16	8	20	31	25	2.4

This question was generally handled well, with most students identifying a suitable tax policy. However, more work needed to be done on examining how the tax initiative might impact aggregate demand and the chosen goal. Many students focused too much on the aggregate supply effects of tax cuts, rather than the aggregate demand effect on disposable income.

Responses that scored the highest marks used a structure similar to the following:

- identify the discretionary measure
- provide some detail of the discretionary measure
- note the impact on household disposable income
- identify and justify the component of aggregate demand that is affected
- identify the overall effect on aggregate demand (*ceteris paribus*)
- link the effect on aggregate demand to production, the derived demand for labour and cyclical unemployment
- explain how these effects influenced the achievement of the selected macroeconomic goal.

The following is an example of a possible response.

In the 2018–19 Budget, the government announced a seven-year income tax plan for ‘lower, fairer and simpler taxes’. The first stage implemented in July 2018 was moving the 32.5% tax bracket from \$87 000 to \$90 000 per annum, offering a small increase in disposable income for medium-income earners. This was combined with changes to the low and medium income tax offset so that low- and medium-income earners could receive a rebate of \$530 per annum, which further increases their disposable income as a lump sum. This is a discretionary change to the Budget that will increase the disposable incomes of households and increase their willingness and ability to consume more goods and services, raising levels of personal consumption expenditure (C), a component of AD. As AD increases, producers may notice an increase in sales and seek to increase production to a rate that is high enough to create jobs, lower unemployment and move closer to the goal of full employment.

Question 4e.

Marks	0	1	2	3	Average
%	10	20	35	34	2

Some students found this question challenging. It appeared that goal selection was crucial in terms of students maximising marks. Very few were able to successfully link the aggregate supply policy with the goal of full employment. Higher-scoring responses discussed low inflation or strong and sustainable economic growth (SSEG). Students need to work on improving the explanation of the link between research and development (R&D) grants and aggregate supply, rather than just stating that it will happen. The biggest problem was welfare reform. While some students were able to successfully argue it could lead to higher participation rates, many assumed this meant lower unemployment. Students need to be reminded that just because someone is looking for work does not mean they will find it.

Examples of high-scoring responses included one of the following approaches:

- R&D grants such as the 150% tax concession for businesses undertaking R&D provide businesses with the incentive to engage in R&D, which can result in technological breakthroughs. Such breakthroughs can result in more efficient production technologies that

boost productivity and push the aggregate supply curve to the right. An increase in the volume of goods and services adds to the economy's ability to achieve SSEG.

- Subsidies or cash payments, such as those given to farmers to maintain their presence on the land in the face of adverse supply-side shocks such as drought, means that farmers can afford feed for their livestock and continue to supply, and in doing so supports the attainment of SSEG.
- Welfare reform policy (for example, the demerit point system for failing to meet mutual obligation), which puts the onus on the hardcore unemployed to make a more concerted effort to secure work, is likely to result in more of these individuals transitioning from welfare into paid employment, and in doing so raise the economy's ability to supply goods and services (raising aggregate supply), promoting the attainment of SSEG and full employment.