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## Level 2 Economics, 2017

### 91223 Analyse international trade using economic concepts and models

2.00 p.m. Monday 20 November 2017  
Credits: Four

Achievement	Achievement with Merit	Achievement with Excellence
Analyse international trade using economic concepts and models.	Analyse international trade in depth using economic concepts and models.	Analyse international trade comprehensively using economic concepts and models.

Check that the National Student Number (NSN) on your admission slip is the same as the number at the top of this page.

**You should attempt ALL the questions in this booklet.**

If you need more room for any answer, use the extra space provided at the back of this booklet.

Check that this booklet has pages 2–11 in the correct order and that none of these pages is blank.

**YOU MUST HAND THIS BOOKLET TO THE SUPERVISOR AT THE END OF THE EXAMINATION.**

Excellence

TOTAL

20

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# QUESTION ONE: EXCHANGE RATES AND THE PRICE TAKER MODEL

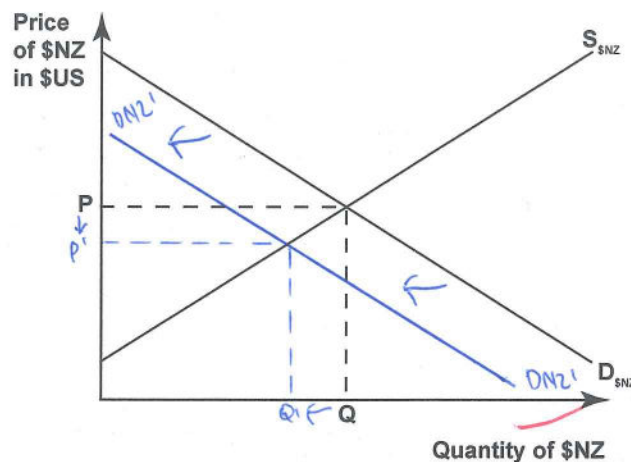
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The United States interest rate is expected to rise to 1.50 per cent by the end of the December 2017 quarter. In the long term, the rate is projected to trend up to around 2.25% in 2020.

Source (adapted): <http://www.tradingeconomics.com/united-states/interest-rate/forecast>

- (a) (i) On Graph One below, show the shift in the demand for the New Zealand dollar that would result from the anticipated rise in interest rates in the United States, assuming interest rates in New Zealand remained constant.

Graph One: Market for the New Zealand dollar



- (ii) Fully explain the shift in demand for the New Zealand dollar that you have shown on Graph One.

The United States interest rate is expected to rise to 1.5% in 2017 and continue to rise to 2.25% in 2020 whereas the interest rates in New Zealand remained constant. This will mean that investors will look to invest their money in the US markets as the increase in interest rates means they will receive more return on their investments. The demand for \$NZ will decrease as a result and the \$NZ curve shifts to the left from  $D_{NZ}$  to  $D_{NZ'}$  where price of \$NZ in \$US decreases from  $P$  to  $P'$ , meaning the \$NZ has depreciated.

New Zealand is a small producer in the international forestry industry, contributing only 1.1% of the world's total supply of industrial wood and 1.3% of the world's trade in forest products. As a result, New Zealand is a price taker.

However, forestry is a significant industry in New Zealand. It contributes:

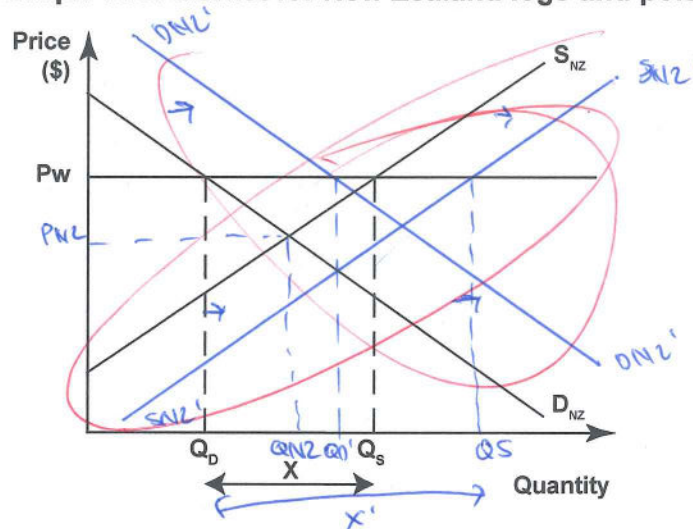
- an annual gross income of about \$5 billion
- 3% of New Zealand's GDP
- direct employment for about 20 000 people.

Wood products are New Zealand's third largest export earner, behind dairy and meat.

Source (adapted): <https://www.mpi.govt.nz/news-and-resources/open-data-and-forecasting/forestry/>

- (b) (i) On Graph Two below, show the impact on export receipts from logs and poles as a result of the changes to the \$NZ exchange rate shown in Graph One.

**Graph Two: Market for New Zealand logs and poles**



- (ii) Using Graph Two, compare and contrast the impact of the changes to the \$NZ exchange rate shown in Graph One on:

- exporters of logs and poles
- employees in the forestry industry.

Due to the increasing interest rates <sup>in</sup> the United States, the NZ dollar has depreciated as the \$NZ exchange rate decreases. As the NZ dollar has depreciated, exports become more competitive in the overseas market as NZ exports become more cheaper. As a result, the demand for NZ logs and poles increases and export

**More answer space is available on the following page.**



receipts for NZ logs and poles increases.

Also, as NZ is a price taker as its market is too small / insignificant to cause any changes

to price, it must accept the world price set

As the world price  $P_W$  is greater than the NZ price  $P_{NZ}$ , exporters will find it more

profitable to sell NZ logs and poles overseas

so they will increase supply of NZ logs and poles. The overall increase in quantity supplied

and quantity demanded for NZ logs and poles will result in an overall increase in

exports from  $X$  to  $X'$  hence, exporters will

earn more revenue and profits and are better off overall. //

NZ employees working in the forestry industry will also see benefits <sup>from</sup> the increase in

exports of NZ logs and poles as ~~due~~ <sup>due</sup> to

the increase in export receipts, demand for NZ logs increases and so these employees may

may be given longer working hours or even an increase in income levels, hence employees

in the forestry industry are also better off if the NZ dollar depreciates and the exports of NZ logs and poles become more competitive. //

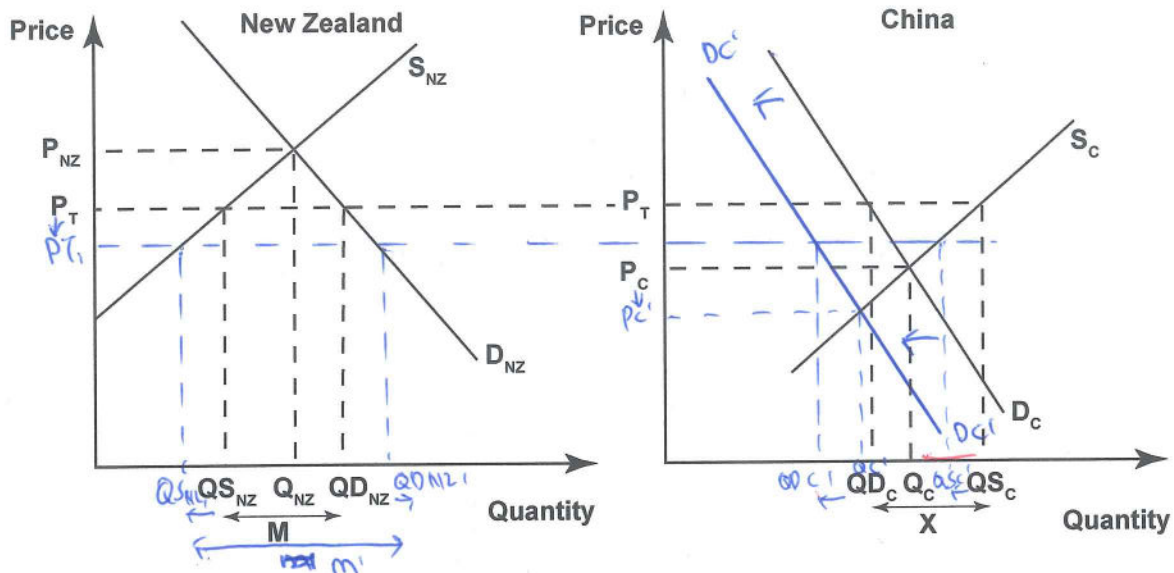
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## QUESTION TWO: THE TWO-COUNTRY MODEL

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New Zealand steel producers compete in the New Zealand steel market with imported steel from China.

Graph Three: Two-country model



- (a) Using Graph Three, fully explain why New Zealand imports steel and why China exports steel.

New Zealand steel producers compete in the NZ steel market with imported steel from China. As shown in the graph above, the market price of steel in New Zealand is much greater than that in China. The market price set in order for trade to take place in the country is below the NZ price and above the price in China. As a result, QS decreases in New Zealand as it is no longer as profitable for producers so they decrease production to maintain profit margins. AD for steel increases however and the opposite occurs for the steel market in China, as the trade price is above their market price. As QD is greater than QS for steel in China, a shortage is created and to fill up this shortage, steel is imported <sup>from China</sup>. On the other hand, high supply of steel and low demand in China means a surplus is created and China will export this surplus of steel to New Zealand as a result.



- (b) (i) On Graph Three, show the impact of falling Chinese demand for steel. Label the new trade price ( $P_{T1}$ ).
- (ii) Using Graph Three, compare and contrast the impact of falling demand for steel in China on the following groups:
- New Zealand steel consumers (e.g. the New Zealand construction industry)
  - New Zealand steel producers.

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A fall in Chinese ~~demand~~ demand for steel will cause the  $D_C$  curve in the China market to shift to the left from  $D_C$  to  $D_C'$ , where the Chinese ~~price~~ <sup>market</sup> price for steel also decreases to  $P_C'$ . Due to this decrease in China market price and New Zealand as a price taker, the ~~trade~~ <sup>new</sup> trade price will decrease from  $P_T$  to  $P_T'$ . As a result of this, NZ steel consumers will benefit as the fall in price means that steel becomes cheaper and more affordable for them, their purchasing power increases and ~~they~~ <sup>they</sup> are able to buy more for less hence <sup>NZ</sup> demand for ~~the~~ steel increases from  $Q_{DNZ}$  to  $Q_{DNZ'}$  as suggested by the law of demand.

New Zealand producers will be worse off as a fall in the trading price for steel means that it is now less profitable for them to produce steel. In order to maintain their profit margins, NZ steel producers will reduce their output and quantity supplied of steel from  $Q_{SNZ}$  to  $Q_{SNZ'}$ . NZ steel producers as a result lose out on their revenue as they will earn less due to the decrease in price and output for steel hence, NZ steel producers are worse off and levels of imports for steel increase from  $m$  to  $m'$ .

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### QUESTION THREE: EFFECTS AND JUSTIFICATION OF TRADE

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A wide range of New Zealand agricultural industries have benefited from free trade agreements with other countries.

- (a) Fully explain TWO advantages of free trade agreements to New Zealand agricultural producers and/or consumers.

A free trade agreement between New Zealand and other countries will benefit <sup>agricultural</sup> ~~agricultural~~ producers as it will reduce any compliance costs of trading for example tariffs, ~~the~~ which ~~free trade~~ is a tax imposed on imported goods. The removal of any tariffs via the free trade agreement will make it much more easier and cheaper for New Zealand and other countries to trade with each other and export to each other. NZ agricultural producers will see an increase in revenue and profits due to the increase in exports. NZ consumers will also benefit from the free trade agreement as there will be more goods available for them in the market due to a possible wider variety of ~~export~~ <sup>imported</sup> producers. The producers will also pass on the benefit of reduced costs of production with regards to the free trade agreement to the consumers so consumers now pay a cheaper price for imported goods.

#### Wairarapa pea farms shut for two years to eradicate pest threatening \$150m industry

All pea production in the Wairarapa will be halted from 1 August 2016, after pea weevils were found in seeds from eight farms. Peas are a \$150 million industry nationwide, and worth about \$15m to Wairarapa, where there are about 120 pea farms.

The potential loss was depressing, "all for no fault of the growers", a pea farmer said. The weevils are believed to have entered the country in a batch of imported seeds.

Suggestions have been made that standards of border security for imports must be improved.

Source (adapted): <http://www.stuff.co.nz/business/farming/82438607/Wairarapa-pea-farms-shut-for-two-years-to-eradicate-pest-threatening-150m-industry>

Laws and regulations that provide biosecurity for the agricultural industry may be viewed as an example of protectionism.



- (b) Using the resource material on page 8, fully explain ONE advantage of protectionism to the agricultural industry, in the form of biosecurity regulations.

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All pea production in the Wairarapa will be halted from 1 August 2016, after pea ~~weevils~~ weevils were found in seeds from <sup>eight</sup> ~~eight~~ farms. As a result, the pea industry in New Zealand, particularly in the ~~Wairarapa~~ Wairarapa area are damaged and as a result, law and regulations that provide bio-security ~~for~~ ~~as~~ ~~prote~~ protectionism is implemented. This biosecurity regulation could be of advantage to the agricultural industry and can benefit them as it ensures that no pea weevils will be found in seeds in the future and will prevent a halt of production from happening again. This will be of benefit to the agricultural industry as they can continue their production and will continue to earn revenue. The \$150 million pea industry will be stable.

- (c) Fully explain whether protectionism or free trade provides greater benefits to agricultural industries.

Free trade <sup>could</sup> provide greater benefits to agricultural industries as opposed to protectionism as although protectionism will prevent any pest threats in the industry, the laws and regulations required for protectionism will increase the costs of production of agricultural industries ~~considerably~~ <sup>greatly</sup>. A free trade agreement ~~however~~, eliminates any extra compliance costs and makes importing/exporting easier however, as stated in the resource material, the pea weevil problem was ~~caused by~~ <sup>originated from</sup> imported seeds so in the long run, the protectionism will provide greater benefits as although it adds to cost of production, the added costs will be outweighed by the extra revenue in return and the elimination ~~of~~ <sup>of</sup> the risk of production shutting down due to pea weevils.

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Excellence exemplar for 91223 2017		Total score	20
Q	Grade score	Annotation	
1	M5	<p>This candidate has received an M5 grade because they have:</p> <ul style="list-style-type: none"> <li>provided a detailed explanation into the shift of the demand for the NZ\$. A rise in interest rates in the US would result in more funds going to US banks and less funds coming to NZ banks. As a result, the demand for \$NZ would fall and the \$NZ would depreciate.</li> <li>integrated Graph One into their detailed explanations.</li> </ul> <p>For an E grade the candidate would have to increase the world price (Pw) in Graph Two and fully explain the effect the effect of the depreciation from part (a) on Pw and the effects of this increase in Pw on exporters of logs and poles and employees in the forestry industry. They would also have to integrate Graph Two into their detailed explanations</p>	
2	E8	<p>This candidate has received an E8 grade because they have:</p> <ul style="list-style-type: none"> <li>provided a detailed explanation into why New Zealand imports steel and China exports steel. NZ imports steel from China because the NZ price without trade is higher than the Chinese price and NZ consumers can get cheaper steel from China than from NZ producers. China exports steel to NZ because NZ pays a higher price for steel than Chinese producers receive from Chinese consumers. At the world price the surplus in China is exported and the shortage in NZ is imported.</li> <li>provided a detailed explanation of the effect of the decrease in falling Chinese demand on New Zealand steel consumers and producers. The fall in demand in China would result in a lower trade price of steel. Consumers of steel will increase their quantity demanded as it is more affordable. The lower trade price means that NZ steel producers would need to also lower their price and reduce their output, and this makes NZ steel producers less profitable and worse off.</li> <li>integrated Graph Three into their detailed explanations.</li> </ul>	
3	E7	<p>This candidate has received an E7 grade because they have:</p> <ul style="list-style-type: none"> <li>provided detailed explanations on the advantages of free trade agreements to consumers and/or producers. Free trade allows producers access to inputs that are made in countries where costs are lower which will increase their profitability. Also, free trade opens markets to producers to get access to more consumers and the demand for their output is increased. This leads to higher prices, sales and profitability</li> <li>provided a detailed explanation on the advantages of protectionism. By preventing foreign pests from entering the country, growers would maintain the output and quality of peas produced without having to pay the additional cost of pest control. This would maintain pea growers' profitability</li> <li>provided a detailed explanation on whether free trade or protectionism would provide greater benefits to agricultural industries.</li> </ul> <p><i>Note: candidates could argue a preference either way with supporting evidence.</i></p>	