

91403



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NEW ZEALAND QUALIFICATIONS AUTHORITY
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Level 3 Economics, 2017

91403 Demonstrate understanding of macro-economic influences on the New Zealand economy

2.00 p.m. Wednesday 29 November 2017

Credits: Six

Achievement	Achievement with Merit	Achievement with Excellence
Demonstrate understanding of macro-economic influences on the New Zealand economy.	Demonstrate in-depth understanding of macro-economic influences on the New Zealand economy.	Demonstrate comprehensive understanding of macro-economic influences on the New Zealand economy.

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 2–12 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.

Merit

TOTAL

13

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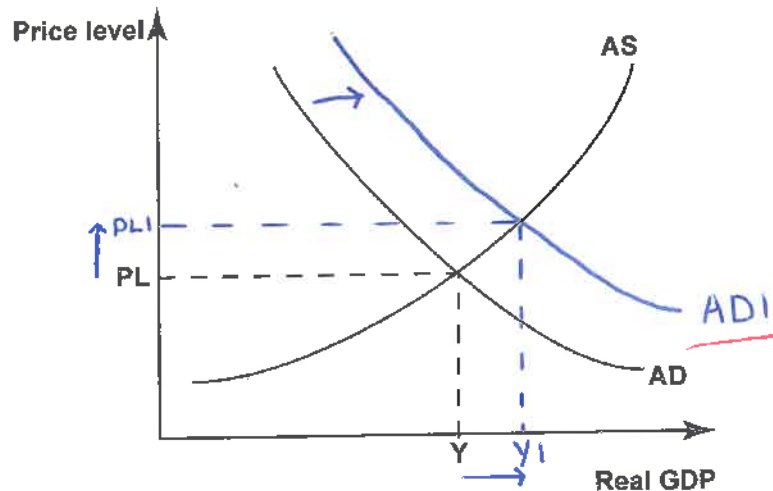
QUESTION ONE: Fiscal and supply side policies

The 2016 Budget included spending on regional roading projects and upgrading regional tourism infrastructure, e.g. extending the New Zealand Cycle Trail.

Source (adapted): <http://www.treasury.govt.nz/budget/2016/at-a-glance/b16-at-a-glance.pdf>

The impact on long-term economic growth of this expansionary fiscal policy may be affected by the multiplier.

Graph One: The New Zealand economy



- (a) (i) ✓ On Graph One above, illustrate the impact of increased spending on regional roading projects and tourism infrastructure on aggregate demand and real GDP. $\uparrow G = \uparrow AD$
- (ii) ✓ Explain in detail the impact of this expansionary fiscal policy on economic growth. In your answer:
- refer to the changes made to Graph One
 - explain why at least two components of aggregate demand, other than Government spending, will increase.

An increase in government spending on regional roading projects and tourism infrastructure will lead to an increase in demand for resources and labour. ^{by producers} Labour is derived demand, based on the demand of the goods & services it produces. Therefore, there will be an increase in demand for tradespeople and workers in the infrastructure industry (because the demand for infrastructure/roading has increased). The increased demand for labour will create more jobs in the roading/infrastructure industry and these workers will receive higher incomes. With higher incomes and more disposable income to spend, consumption by these households will increase. With upgraded regional tourism infrastructure, ~~there~~ overseas tourists will be more willing and

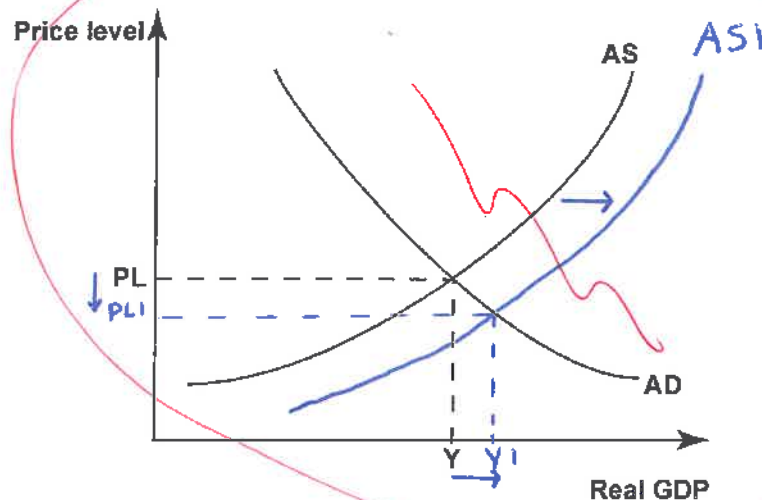
Supply side policy includes any policy that improves an economy's productive potential and its ability to produce.

Source: http://www.economicsonline.co.uk/Global_economics/Supply-side_policies.html

The 2016 Budget also included spending on tertiary education and apprenticeship programmes, to develop the skilled workforce needed for a 21st century economy.

Source (adapted): <http://www.treasury.govt.nz/budget/2016/at-a-glance/b16-at-a-glance.pdf>

Graph Two: The New Zealand economy



- (b) On Graph Two above, illustrate the impact of increased spending on tertiary education and apprenticeship programmes on real GDP, assuming that this expansionary fiscal policy is also an example of a supply side policy.
- (c) Referring to the resource material on pages 2 and 3 and Graphs One and Two, compare and contrast the impact on long-term economic growth of these two policies. In your answer, explain in detail:
- the impact of increased spending on tertiary education and apprenticeship programmes on economic growth
 - whether increased spending on regional roading projects and tourism infrastructure or increased spending on tertiary education and apprenticeship programmes would have the greater impact on long-term economic growth.

An increase in spending on tertiary spending and apprenticeship programmes will lead to an increase in aggregate supply because a skilled '21st century' workforce improves NZ's ability to produce and ^{improves} our productive potential. This means that the skilled workforce will not only improve NZ's productive capacity (ability to increase production of GTS in the future) but also our productivity because they increase NZ's resources and may improve our level of

More answer space is available on the next page.

technology. ^{as they acquire innovative skills} The AS curve shifts to the right from AS to AS1. With an increase in aggregate supply, Real GDP increases from Y to Y1 and economic growth increases.

Increased spending on tertiary education and apprenticeship programmes is likely to have the greater impact on ^{long-term} economic growth because the policy will ~~impact on the short-term~~

~~improve NZ's productive capacity / potential~~ improve NZ's productive capacity / potential. This means that because NZ has an ^{increased} ~~larger~~ skilled labour workforce ^{in many different industries} ~~(due to the policy)~~ ^{increased resources},

more goods and services will be able to be produced in the ^{economy in the} future and ^{this means} real GDP (output) will be able to continue ^{to increase} in the future. Long-term economic growth is therefore achieved. In contrast, increased spending on regional roads & infrastructure will have a

limited impact on long-term economic growth because the policy ~~is~~ ^{short-term and is} focussed on the regions and the building / tourism industries only. This means that ~~the shift to the right of the AS curve (AS to AS1) will be greater than the shift to the right of the AD curve (AD to AD1).~~ ~~the shift to the right of the AS curve (AS to AS1) will be greater than the shift to the right of the AD curve (AD to AD1).~~

$$CAB = X - M$$

goods 1st income
services 2nd income

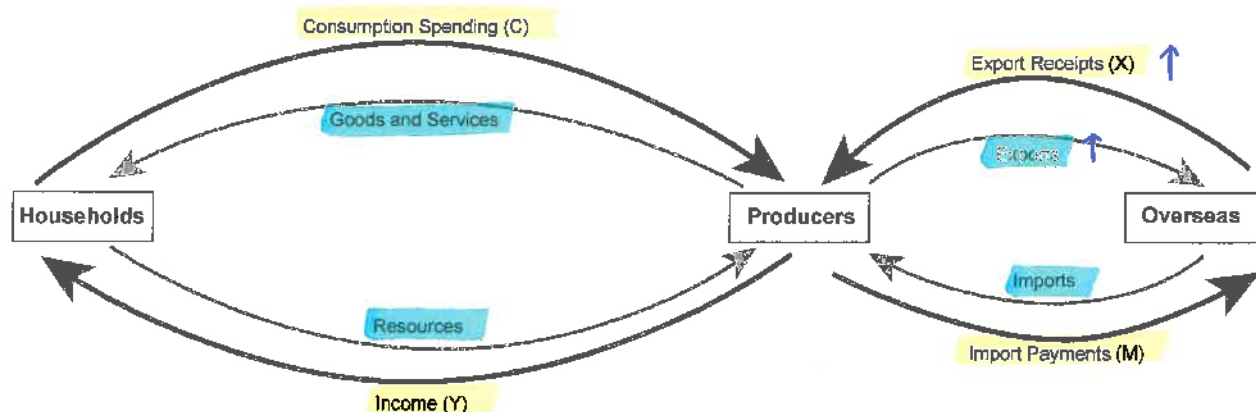
QUESTION TWO: Impact of free trade agreements on the current account and employment

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As at the beginning of 2017, New Zealand has successfully concluded free trade agreements involving 16 countries that are members of the World Trade Organisation. New Zealand is negotiating to conclude another five free trade agreements involving significant economies such as India.

Source (adapted): <https://www.mfat.govt.nz/en/trade/free-trade-agreements/free-trade-agreements-in-force/> and <https://www.mfat.govt.nz/en/trade/free-trade-agreements/agreements-under-negotiation/>.

Model One: Simple circular flow model showing New Zealand producers, households, and the overseas sector



- (a) Referring to changes in the relevant **real** and **money** flows from Model One, explain in detail how New Zealand's entry into a **further five free trade agreements** could improve New Zealand's **current account**.

A further five free trade agreements (FTA) will lead to an increase in demand for NZ exports from overseas and therefore an increase in export receipts (as NZ exports are now more price competitive). The further 5 FTAs ^{may} ~~also~~ also lead to an increase in demand for imports (eg. raw imported materials) from ~~NZ producers~~ ^{NZ producers} and therefore an increase in import payments as production increases and imports become relatively more affordable. Assuming the increase in exports is larger than the increase in imports NZ's current account will improve as per the equation $CAB = X - M$ (exports - imports). It is likely we will export more goods than import because NZ is a relatively small country exporting to larger countries with larger demands. //

- (b) Referring to changes in the relevant real and money flows from Model One, explain in detail how New Zealand's entry into a further five free trade agreements could increase employment in New Zealand.

NZ's entry into a further 5 FTA's could increase employment in NZ because increased demand for exports from overseas will lead to increased production/output by firms. With increased output, more ~~than~~ labour and resources ~~are~~ ^{is} required ~~to~~ so demand for labour will increase. Labour is derived demand, based on the demand for the ^{good or service} it produces. Resources demanded by producers from households in the form of labour will increase and so more jobs are created, ~~and~~ leading to increased employment in NZ. //

(2)

- (c) Explain in detail whether the new free trade agreements could be more effective in helping achieve the goals of either a balanced current account or full employment for the New Zealand economy.

The new FTAs will likely be more effective in helping achieve the goals of a balanced current account in NZ because they directly affect a wide range of exports and imports (which are components of the current account). The FTAs ^{help balance} ~~improve~~ NZ's current account by increasing both exports and imports.

Current Account = Exports - Imports

The new FTAs will be less effective in helping achieve the goal of full employment in NZ because the increased demand for labour will be limited to firms who experience an increased demand of their goods & services due to the FTAs. Only workers in such ^{export/related} industries will benefit from the FTAs

(3)

labour is
derived demand
this means...

so the agreements will have limited impact on NZ's goal of full employment. Industries such as teachers or ~~foreigners~~^{engineers} will be unlikely to experience an increase in demand for their labour directly due to the FTAs. Full employment is therefore unlikely to be attained directly through the FTAs. //

A3

QUESTION THREE: Impact of savings and investment on the economy

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"... saving is undeniably an important part of the economic process that gives rise to new investment and economic growth."

Source (adapted): <http://www.abc.net.au/money/currency/features/feat4.htm>

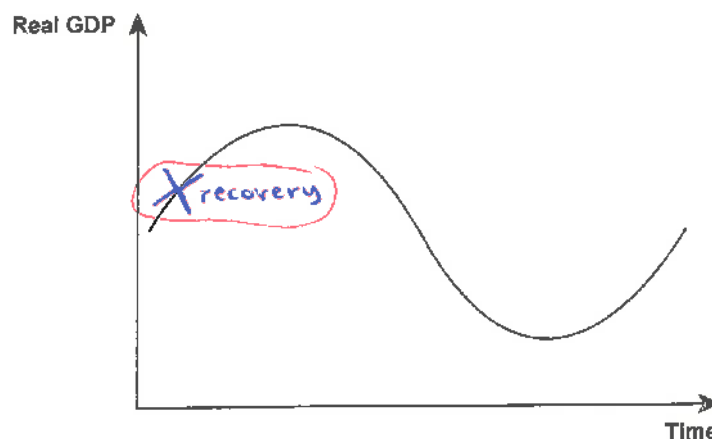
- (a) Explain in detail how increased savings may result in more investment in the economy. In your answer, define the terms "savings" and "investment".

Savings refer to a ^{portion of a} consumer's income which is ^{"foregone"} (not spent) now so it can be spent in the future. Increased savings by consumers means that financial institutions such as banks have more funds to loan out. This may result in more investment (which is spending on capital goods by producers) because banks are more willing and able to loan out increased amounts to producers because they have increased funds available (due to consumers' increased savings).

(1)

The magnitude of the impact of increased investment on the economy is dependent on New Zealand's position on the business cycle.

Model Two: The business cycle



(2)

- (b) (i) Using Model Two, identify a possible position of the New Zealand Economy if it is close to achieving the full employment level of output.

- (ii) Referring to the relevant stage of the business cycle, explain in detail why you chose the position identified in (i).

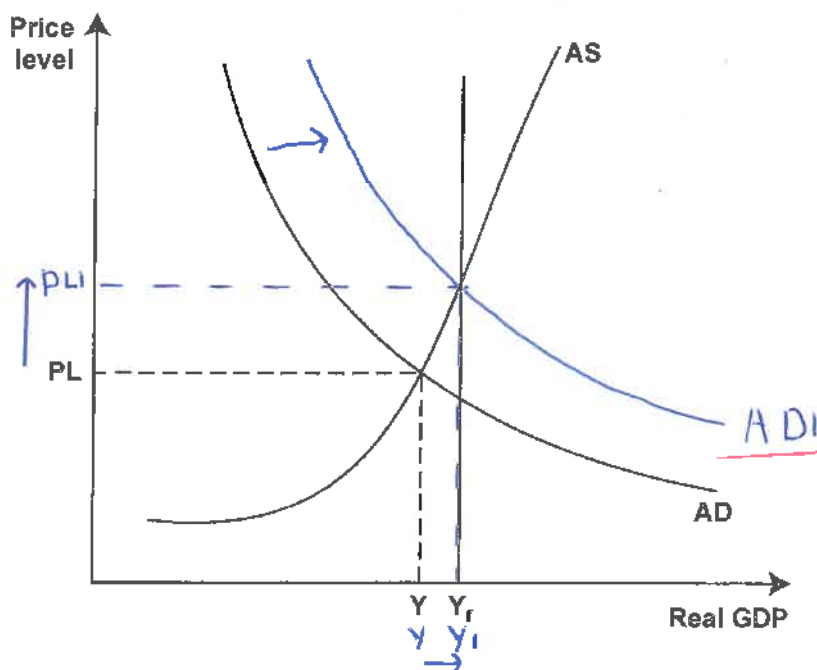
During a recovery stage, economic activity is increasing, demand for resources & labour ^(because sales and profits are increasing) is increasing and unemployment is decreasing. Therefore, employment is increasing and the NZ economy becomes close to achieving the full employment level of output. ~~However~~ ~~however~~ Full employment level of output is not yet achieved so the economy is close to, but not yet at a boom stage!

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(3)

- (c) (i) On Graph Three below, show the impact of increased investment on the price level and real GDP, assuming that full employment is reached.

Graph Three: The New Zealand economy operating close to the full employment level of output (Y_f)



(4)

The question continues on the next page.

- (ii) Referring to Graph Three and Model Two, compare and contrast the impact of increased investment on the goals of price stability and economic growth when the economy is close to full employment. In your answer, explain in detail:

- the impact of increased investment on the price level and real GDP ✓
- the effectiveness of increased investment in achieving price stability and significant economic growth in the **short run** when the economy is operating close to the full employment level of output.

Increased investment ^{and spending} by producers on capital goods will lead to an increase in aggregate demand as per the equation $AD = C + I + G + (X - M)$. The AD curve will shift to the right from AD to AD1. With an increase in AD, price level will increase (PL to PL1) leading to ^{an increase in} demand-pull inflation and real GDP will also increase (Y to $Y1$) leading to an increase in economic growth. Increased investment

will be effective in achieving significant economic growth in the short run ^(when economy is operating close to full employment = recovery) because ~~investment is a component of real GDP~~ investment is a component of real GDP ($GDP = C + I + G + (X - M)$) and so economic activity/growth will also increase. The value of goods and services produced in NZ increases with investment. During a recovery phase of the business cycle, pressure on prices to rise is increasing. Increased investment ^{will} help achieve price stability in the short run provided the ^{increase in} ~~short run~~ PL to PL1 does not exceed the 1% - 3% target range (as price stability = ^{inflation} ~~prices~~ between 1% - 3% over the medium term). Overall, increased investment is effective in achieving ^{both} price stability and significant growth in the short-run. In the long-run, increased investment ^{may} ~~will~~ cause...

Extra space if required.

Write the question number(s) if applicable.

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1a.ii) able to travel to the regions and spend their money on goods and services whilst there. Increased tourism due to the upgraded infrastructure will therefore lead to an increase in export receipts. Because consumption and export receipts are both components of aggregate demand ($AD = C + I + G + (X - M)$), ~~A~~ aggregate demand will increase and the AD curve will shift to the right from AD to AD1. With an increase in AD, real GDP will increase from Y to Y_1 and economic growth will increase. //

3c.ii) the economy to enter a boom phase of the business cycle if full employment is reached. Economic growth will be high however pressure on prices to rise will also be high and it is likely prices levels will increase above the 1% 3% target meaning prices will no longer be stable. //

Merit exemplar 2017

Subject:		Economics	Standard:	91403	Total score:	13
Q	Grade score	Annotation				
1	M5	<p>This candidate has received M5 for this question because they:</p> <ul style="list-style-type: none"> a) shifted and labelled the AD curve correctly on Graph One, (1) and fully explained how Consumer Spending and Export Receipts would also increase, linking this to increased economic growth and the model. (2) (Continued on Page 11) b) failed to shift and label the AD curve correctly on Graph Two. (3) c) explained how the increased government spending would lead to improved productivity and an increase in AS and cause economic growth (4), while including reference to Graph Two. A more detailed answer would have recognised that the increased government spending would have initially increased AD and fully explained why this would have occurred. This would then allow a more relevant comparison between Policy One and Policy Two. 				
2	A3	<p>This candidate has received A3 for this question because they:</p> <ul style="list-style-type: none"> a) Explained that NZ's entry into further FTA's will lead to increased exports and export receipts for NZ, improving NZ's Current Account. (1). A more detailed answer would have explained how the FTAs would reduce protectionism and make NZ's exports more price competitive and included correct reference to at least one component of the Current Account. b) Explained that the increase in export receipts would lead to increased production in NZ and, due to the derived demand for labour, lead to increased employment in NZ. (2) A better answer would have referred to a relevant money flow from Model One. c) Failed to provide a detailed explanation as to whether the new TAs will be more effective in helping achieve a balanced current account or full employment for the NZ economy. (3) 				
3	M5	<p>This candidate has received M5 for this question because they:</p> <ul style="list-style-type: none"> a) Defined Savings and Investment and provided a detailed explanation linking increasing funds saved and increasing funds available for investment. (1) b) incorrectly identified a position on the business cycle where the NZ economy would be close to achieving the full employment level of output, (2) but then explained why this point is close to the full employment level of output. (3) c) shifted and labelled the AD curve correctly in Graph Three so full employment is reached, (4) and fully explained how an increase in investment caused this shift. (5) They recognise that the increase in price level is inflationary but do not explain why and incorrectly state the investment will be effective in achieving price stability and significant growth. (6) A more detailed explanation would have linked the price instability and lack of significant economic growth to the scarcity of resources. 				