

You are advised to spend 60 minutes answering the questions in this booklet.

Assessor's  
use only

## QUESTION ONE

The creation of a 3000 km national cycleway, from Kaitia to Bluff, moved a step closer to reality yesterday when Prime Minister John Key took charge of the plan, indicating it would cater for all cyclists ...

Key said the creation of the cycleway could create "a lot of potential jobs", although it was too early to say how many or when it could start ...

Source (adapted): *New Zealand Herald* 11 March 2009.

- (a) Describe what **fiscal policy** is.

Manipulating money supply by changing government spending and government revenue (eg. taxation) to achieve certain economic objectives eg. growth.

- (b) Explain how the proposed cycleway would have **flow-on effects** to the New Zealand economy that also contribute to economic growth, eg health benefits, positive effects on small rural communities, etc.

A new cycleway will mean households will have a new pathway to walk or cycle through, instead of cycling through the polluted highway (by cars) and so their standard of living will increase. This benefits their health as they no longer need to cycle through a polluted highway. Because of this new pathway, firms producing bicycles will face increased demand and profits for their products (bikes), due to more households purchasing bicycles to use to travel through the cycleway. The cycleway produces a more efficient way to travel to local areas, so therefore households will travel to local areas in a shorter time, ~~therefore~~ therefore local firms from small rural communities will face increased demand and profit for their products, which cause economic growth to the whole community, as they will profit for their products, which cause economic growth to the whole community, as they will increase production and become more confident to employ more workers, to increase employment.

Flow on effects  
relate to economic growth.

Both spending  
& revenue  
required

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PAYE tax rates and thresholds before 1 April 2009		New PAYE tax rates and thresholds from 1 April 2009	
Income thresholds	Rates (%)	Income thresholds	Rates (%)
Income to \$14 000	12.5	Income to \$14 000	12.5
\$14 001 – \$40 000	21	\$14 001 – <b>\$48 000</b>	21
\$40 001 – \$70 000	33	<b>\$48 001</b> – \$70 000	33
\$70 001 and over	39	\$70 001 and over	<b>38</b>

Source: <http://www.ird.govt.nz/news-updates/like-to-know-april-2009-tax-changes.html#01>

(c) **Fully explain the purpose** of the tax cuts of 1 April 2009 AND the intended **effects** on the New Zealand economy.

Your answer should include explanations of:

- why the tax cuts were considered necessary
- how the tax cuts were intended to affect the economy
- why the intended effects may not occur.

Tax cuts for income earners of \$70000 or over decreases from 39% to 38% as of 1 April 2009. These income earners will receive more disposable income because of tax cuts. This ~~is~~ influences more consumer spending and results in firms increasing production to meet the increased demand. This causes economic growth. Tax cuts are ~~and~~ a form of <sup>expansionary</sup> ~~the~~ fiscal policy (decrease government revenue) to increase economic activity and is necessary to encourage economic growth. Tax cuts were intended to increase economic growth in New Zealand.

However this may not occur because even though households are ~~not~~ facing increased disposable income, they may not be willing to spend, and instead save more in financial institutions which do not increase economic activity, thus no economic growth.

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## QUESTION TWO

Assessor's  
use only

Petrol taxes will rise 6c a litre under the Government's plans to build more roads.

Source: <http://www.stuff.co.nz/national/politics/2267756/Petrol-tax-to-rise-6c-a-litre>

- (a) State the effect of **expansionary fiscal policy** on inflation.

Increase ✓

- (b) Explain the effect of the **petrol tax** on inflation.

Petrol is a form of transport costs for most, if not all, firms. Because of an increase in petrol tax by 6c a litre, the price of petrol increases. Firms will face increased transport costs, which increase their cost of production, causing aggregate supply to decrease, and raising the price level causing cost push inflation. ✓

- (c) Fully explain how the **development** of more roads will contribute to economic growth, AND discuss whether **inflationary consequences** would reduce that contribution.

More roads mean most firms will have more efficient ways to transport goods and services. ✓

This means firms will face decreased transport costs as they ~~can~~ can move goods and services more efficiently, and so ~~that~~ they can produce and supply more goods and services. Firms become confident and more firms will move into the local area as ~~there~~ there is better roads, and so employment will rise, causing increased disposable income of households and increased consumer spending to increase economic activity and growth. Inflationary consequences is increased (cost push) inflation. Both ~~decrease~~ decrease according to the growth. Inflationary consequences is increased (cost push) inflation, and that reduces real GDP to decrease economic growth, so that reduces the increase in economic growth.

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## QUESTION THREE

Assessor's  
use only(a) State TWO examples of **protectionism**.(1) Government subsidies on exporting firms.(2) Tariff on imports.(b) Explain why the New Zealand government is **eager** to sign free trade agreements with other countries. Include a definition of a free trade agreement in your explanation.

A free trade agreement is an agreement between 2 or more countries to remove trade barriers.

A free trade agreement with other countries will result in free movement of exports, and cheaper exports to other countries, resulting in increased export receipts for New Zealand firms. Imports also become cheaper so consumers have a higher variety of imports. The NZ government is eager for a free trade agreement with other countries as it results in increased export receipts and cheaper imports <sup>(decrease import payments)</sup> and a more variety of goods and services by consumers to increase standard of living.

Refers to the agreement

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incorrect  
Mpt  
Volumes  
will  
increase

On 15 November 2008, the leaders of the 20 most powerful countries in the world signed a pledge to avoid protectionist measures. However, since then, several countries, including 17 of the 20, have implemented 47 measures whose effect is to restrict trade at the expense of other countries.

Source (adapted): <http://www.voxeu.org/index.php?q=node%2F3183>

- (c) **Fully explain** why protectionist policies may have been used **more** by New Zealand's export partners since the beginning of the recession.

Include an example involving goods that New Zealand exports or a destination for New Zealand exports.

Protectionist policies are policies that restrict free trade by creating trade barriers.

New Zealand is a specialist at producing dairy products. Because of this, governments from other countries will want to protect their local firms, by ~~the~~ placing a tariff on dairy imports, or subsidising their agricultural industry.

For example, during a recession there is decreased economic activity and business confidence. Some overseas firms cannot face increased competition from cheaper imported dairy products from NZ that we can, as we can produce dairy products more cheaply, and may be forced to close down, and the overseas government, eg USA, will subsidise production of agricultural firms in their countries to increase employment and not close down, to increase economic growth.

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## QUESTION FOUR

Assessor's  
use only

- (a) Describe how the **level of trade** affects New Zealand's economic growth.

Increase export receipts means increase in NZ economic growth.

A.

- (b) Explain how **protectionist policies** adopted by New Zealand's trading partners could **affect** economic growth in New Zealand.

Protectionist policies restrict NZ's ability to access larger markets and ~~increase~~ increase their exports. As a result, export receipts will decrease if protectionist policies are applied, which mean less profit for NZ exporters. Less income will flow to households meaning less consumption spending, and less business confidence causing less investment, so production of firms will decrease causing a decrease in economic growth.

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New Zealand and India agreed to undertake a joint study into the implications of a free trade agreement in 2007. The study is now complete.

Minister of Trade Tim Groser and his Indian counterpart, Minister Kamal Nath, agreed that, subject to the approval processes of both governments, the two countries would look to commence FTA negotiations by the end of 2009.

Source: <http://www.mfat.govt.nz>

- (c) **Fully explain** why New Zealand, having only recently signed a free trade agreement with China, continues to pursue free trade agreements with other countries such as India. In your explanation, you should discuss:

- the reasons for seeking new markets
- why India is an attractive export market for New Zealand
- the effect of a free trade agreement on New Zealand's standard of living.

~~the~~ Although NZ already has a free trade agreement with China, NZ will want to access larger markets to further increase export receipts and decrease import payments. NZ can rely on many markets instead of just one.

India is not a specialist at producing dairy products, and a free trade agreement ensures that NZ will be able to export dairy products at a lower price to India, so that NZ exporters of agricultural products face increased demand and export receipts (profit). so India is an attractive market.

A free trade agreement also means imports can be imported more cheaply from India, so consumers will have a higher variety of products so NZ's standard of living will increase.

Check the 3 bullet  
parts are covered  
the 2 imports are  
parts are a  
→ cheap imports are a  
side product.



## QUESTION FIVE

Assessor's  
use only

The Official Cash Rate (OCR) is the **main tool** used by the Reserve Bank of New Zealand (RBNZ) to control inflation.

- (a) State ONE **other** policy tool of the RBNZ.

Open market operations ✓

- (b) Explain how **inflation** is affected when the RBNZ **increases** the OCR. Refer to **consumers** and **producers** in your answer.

When RBNZ increases the OCR, <sup>registered</sup> banks follow suite and raise their interest rates. This encourages consumers to save more as they will receive more interest, so they will ~~be~~ spend less. Producers have a higher cost of borrowing and so they will decrease their borrowing and invest less. Less consumption spending (C) and investment (I), means decreased aggregate demand which decreases the price level (decrease demand pull inflation)

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- (c) **Fully explain** why the RBNZ **decreased** the OCR by 5.75 percentage points between February 2008 and April 2009.

Assessor's  
use only

When the RBNZ decreases OCR by 5.75% between February 2008 and April 2009, registered banks are also influenced to do the same, and so retail interest rates decrease during this period.

This will encourage economic activity. A decrease in interest rates mean consumers will earn less interest from savings and so they will switch to spending. <sup>so consumer spending increases</sup> Firms also have a decreased cost of borrowing so they borrow more and invest more into capital equipment. This increases economic activity and production to increase economic growth. Employment will also rise, as demand for goods and services increase.

The RBNZ decreases the OCR during this period, to hopefully increase economic activity and economic growth during the recession of this period.

↑  
Excellence.

this states why  
by using "recession"  
in

E

## QUESTION SIX

- (a) Describe what happens to the **foreign exchange rate** when the Official Cash Rate (OCR) increases (*ceteris paribus*).

Increase (appreciation) of NZ dollar

- (b) Explain the **links** between an increasing **inflation rate** and an increase in the **foreign exchange rate**. State which sector is negatively affected.

~~Increase~~ Increase in the OCR means retail interest rates will be influenced to increase.

Overseas foreigners will demand for more of the NZ dollar, as increased retail interest rates will encourage foreign investment in retail banks.

Hence the NZ dollar appreciates. The NZ ~~exporters~~ exporters will face ~~a decrease~~ a decrease in the demand for exports because exports became more ~~expensive~~ expensive for overseas foreigners due to an appreciation, and this results in a decrease export receipts for exporters in the producer sector.

Imports become cheaper due to an appreciation so demand for imports increase and import payments increase, which will decrease net exports ( $X-M$ ), decreasing aggregate demand and price level, reducing inflation. Increase foreign exchange results in a decrease in inflation rate.

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## QUESTION ONE

The creation of a 3000 km national cycleway, from Kaitaia to Bluff, moved a step closer to reality yesterday when Prime Minister John Key took charge of the plan, indicating it would cater for all cyclists ...

Key said the creation of the cycleway could create "a lot of potential jobs", although it was too early to say how many or when it could start ...

Source (adapted): *New Zealand Herald* 11 March 2009.

(a) Describe what **fiscal policy** is.

That ~~changing~~ ~~of~~ ~~the~~ ~~government~~ ~~revenue~~ ~~and~~ ~~expenditure~~ to influence economic activity.

(b) Explain how the proposed cycleway would have **flow-on effects** to the New Zealand economy that also contribute to economic growth, eg health benefits, positive effects on small rural communities, etc.

The creation of a New Zealand cycleway would increase employment, as staff will be needed to build the cycleway throughout New Zealand. This will increase consumers' disposable incomes. ~~A~~ <sup>The</sup> cycleway would be a tourism attraction for New Zealand and so more tourists will visit smaller rural communities, ~~increasing~~ <sup>as they ride</sup> ~~it~~ <sup>along</sup> it. This will generate income for these communities, increasing their local economies. Both will increase ~~the~~ aggregate demand.

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(c) Fully explain the purpose of the tax cuts of 1 April 2009 AND the intended effects on the New Zealand economy.

Your answer should include explanations of:

- ✓ why the tax cuts were considered necessary
- ✓ how the tax cuts were intended to affect the economy
- ✓ why the intended effects may not occur.

~~The~~ Tax cuts are an example of expansionary fiscal policy, they stimulate the level of economic activity in the economy. Because New Zealand was in the middle of a global recession, consumer spending was low. Those who earned the most money were being heavily taxed at 39%, further limiting consumer spending. By decreasing the tax rates for high income earners and increasing the income threshold for lower tax brackets, the government has increased consumers disposable income. This means consumers are now more willing and able to demand goods and services, increasing consumer spending. This increases aggregate demand, ~~increasing the price level~~ <sup>substituting the price level</sup>. However, these effects may not occur as ~~planned~~ <sup>intended</sup> as consumers may choose to save this money, which is an unintended effect from the greater flow. ✓

11/11

## QUESTION TWO

Assessor's  
use only

Petrol taxes will rise 6c a litre under the Government's plans to build more roads.

Source: <http://www.stuff.co.nz/national/politics/2267756/Petrol-tax-to-rise-6c-a-litre>

(a) State the effect of **expansionary fiscal policy** on inflation.

Inflationary pressures will increase.

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(b) Explain the effect of the **petrol tax** on inflation.

Inflation is a rise in the general price level. A petrol tax will increase a firm's cost of production as petrol is commonly used for transportation. This will decrease aggregate supply, shifting the curve to the left. This increases the general price level (cost-push inflation) and so increases inflationary pressures.

M

(c) Fully explain how the **development** of more roads will contribute to economic growth, AND discuss whether **inflationary consequences** would reduce that contribution.

If the government increases its spending on the development of more roads, consumers' disposable income will increase as employment will increase to build these roads. This is an injection into the circular flow which will increase consumption spending as consumers are more willing and able to demand goods and services. This will increase aggregate demand, shifting the curve to the right. This increases real income (GDP) which is an increase in economic growth. However, this specific fiscal policy spending is inflationary as by increasing aggregate demand, it pushes up the general price level (demand-pull inflation). This is inflation. Therefore inflationary consequences will have to be weighed up against the potential economic growth.

inadequate conclusion.

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## QUESTION THREE

Assessor's  
use only(a) State TWO examples of **protectionism**.(1) Quota ✓ - Quantity restriction on imports.(2) Tariff ✓ - Tax on imports.(b) Explain why the New Zealand government is **eager** to sign free trade agreements with other countries. Include a definition of a free trade agreement in your explanation!

A free trade agreement is between two or more countries that eliminates artificial trade barriers.

New Zealand is a relatively small country and quite far away from most of its major trading partners and so it relies heavily on trade. Because of our geographical location our cost of productions are high and so we are not as competitive. Artificial trade barriers like quotas and tariffs add to NZ producers cost of production, making our exports relatively less profitable. If NZ signed other free trade agreements

like the C.E.R. (Closer Economic Relations) agreement with Australia, trade will increase. Increasing our export receipts, which is an injection to the New Zealand economy.

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Needs to refer to the formal agreement

A



On 15 November 2008, the leaders of the 20 most powerful countries in the world signed a pledge to avoid protectionist measures. However, since then, several countries, including 17 of the 20, have implemented 47 measures whose effect is to restrict trade at the expense of other countries.

Source (adapted): <http://www.voxeu.org/index.php?q=node%2F3183>

- 7(c) **Fully explain** why protectionist policies may have been used **more** by New Zealand's export partners since the beginning of the recession.

Include an example involving goods that New Zealand exports or a destination for New Zealand exports.

Protectionist policies are used by governments to encourage domestic industries by putting in place various trade barriers e.g. quotas and tariffs. Since the beginning of the global recession these protectionist policies have been used more by some of New Zealand's major trading partners as these countries' governments are trying to stimulate their domestic economy. For example as second biggest trading partner the United States of America (USA) is trying to regain consumer confidence by ~~protecting~~ subsidising some of its most important industries, vehicle manufacturers and agriculture. By doing this it decreases trade between the USA and NZ but it helps encourage consumption and investment spending in ~~the domestic economies~~ the US.

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## QUESTION FOUR

Assessor's  
use only

- (a) Describe how the **level of trade** affects New Zealand's economic growth.

The more ~~the~~ goods NZ exports, the more money that comes into our economy. The greater the investment in capital goods, which is economic growth.

- (b) Explain how **protectionist policies** adopted by New Zealand's trading partners could **affect** economic growth in New Zealand.

If one of our major trading partners ~~is~~ begins charging us tariffs (a tax on imports) to import goods into their country, then our export receipts will decrease as exporting is relatively less profitable. NZ firms will decrease their investment in capital goods, as ~~these~~ <sup>protectionist</sup> measures have made our goods less competitive and so demand has decreased. This will decrease our total output, which is a decrease in productive capacity. This is a decrease in economic growth.

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New Zealand and India agreed to undertake a joint study into the implications of a free trade agreement in 2007. The study is now complete.

Minister of Trade Tim Groser and his Indian counterpart, Minister Kamal Nath, agreed that, subject to the approval processes of both governments, the two countries would look to commence FTA negotiations by the end of 2009.

Source: <http://www.mfat.govt.nz>

(c) **Fully explain** why New Zealand, having only recently signed a free trade agreement with China, continues to pursue free trade agreements with other countries such as India. In your explanation, you should discuss:

- ✓ the reasons for seeking new markets
- ✓ why India is an attractive export market for New Zealand
- ✓ the effect of a free trade agreement on New Zealand's standard of living.

A Free Trade agreement provides the removal of artificial trade barriers, to encourage trade. Although New Zealand has only recently signed a FTA with China, we rely heavily on trade to inject money into our economy and so we seek FTAs with new markets. India is (quite close) to New Zealand and so transportation costs will be lower, this will decrease our firms cost of production. India is also a developing nation that has one of the highest populations in the world, which would significantly increase our export demands. If New Zealand did sign a FTA then more money would flow into the economy through the form of export receipts and so the consumer disposable income will increase. This will increase New Zealand's standard of living.

(relatively close)

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This is almost excellence but "more money" detracts from it and detracts from it was the geographic error of India being "quite close"

## QUESTION FIVE

Assessor's  
use only

The Official Cash Rate (OCR) is the **main tool** used by the Reserve Bank of New Zealand (RBNZ) to control inflation.

(a) State ONE **other** policy tool of the RBNZ.

Daily Settlement Cash Deposit Scheme

(b) Explain how **inflation** is affected when the RBNZ **increases** the OCR. Refer to **consumers** and **producers** in your answer.

When the RBNZ increases the OCR, it forces the market interest rates to increase also due to the settlement cash deposit scheme. This makes borrowing less affordable and saving more attractive and so consumption and investment spending decrease. Both of these effects decrease aggregate demand, shifting the curve to the ~~right~~ <sup>left</sup>. This ~~increases~~ decreases the general price level, which is deflation. So when the RBNZ increases the OCR it decreases the rate of inflation.

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- (c) Fully explain why the RBNZ decreased the OCR by 5.75 percentage points between February 2008 and April 2009.

Assessor's  
use only

Between ~~2008~~ February 2008 and April 2009 there has been a world-wide recession. This has caused consumption and investment spending to decrease world wide. In order to ~~with~~ stimulate the level of economic activity in New Zealand the RBNZ decreased the OCR by 5.75 percentage points during this time. This ~~is done to~~

By decreasing the O.C.R., borrowing becomes relatively more affordable as ~~the requirement of~~ interest rates ~~are~~ <sup>have</sup> decreased. This makes saving less attractive also. Both of these increase consumption and investment spending, which is an increase in aggregate demand. This shifts the curve to the right. Increasing real income (GDP), which is an increase in economic growth. Therefore the RBNZ has helped stimulate the level of economic ~~activity~~ activity.

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## QUESTION SIX

Assessor's  
use only

- (a) Describe what happens to the **foreign exchange rate** when the Official Cash Rate (OCR) increases (*ceteris paribus*).

The New Zealand dollar appreciates

- (b) Explain the **links** between an increasing **inflation rate** and an increase in the **foreign exchange rate**. State which sector is negatively affected.

Inflation is a rise in the general price level.

If the rate of inflation is increasing then the RBNZ will try and control this by increasing the Official Cash Rate (OCR). This will increase the market exchange rates in New Zealand, making ~~foreign~~ foreign investors want to invest their money here as it is relatively more profitable. This increases the demand for the New Zealand dollar ~~at~~ (an increase in the foreign exchange rate) and so the New Zealand dollar appreciates.

This negatively affects exporters as it makes their goods and services relatively less ~~profitable~~ affordable and less competitive.

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(c) Fully explain how an increasing inflation rate affects exports AND imports.

Assessor's use only

In your explanation, also refer to the impact on the current account.

Inflation is a rise in the general price level. If inflation increases then our exports become relatively less affordable for foreign markets, making NZ exports less competitive\* This decreases export receipts. Import Payments increase as New Zealand citizens can buy more for their dollar overseas, have greater purchasing power. Both of these effects decrease net exports, which ~~decreases~~ <sup>decreases</sup> ~~decreases~~ <sup>decreases</sup> our balance of trade, which negatively affects New Zealand's current account deficit.

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\* Compared to those countries with low levels of inflation

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(E)