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## **PRESCRIPTION: 120 THE ECONOMIC ENVIRONMENT**

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Last date for assessing this prescription is 31 December 2008

**INTRODUCED** 1991  
**REVISED** 1999 (Implemented Semester One 2000)

### **AIM OF SUBJECT**

To enable students to apply elements of economic theory to contemporary issues.

### **ASSUMED PRIOR KNOWLEDGE**

Nil

### **COURSE LENGTH**

The equivalent of 20 National Qualifications Framework credits, with a minimum of 60 class contact hours or the equivalent for open learning/distance tuition.

### **RESOURCES**

#### *Suggested student text references*

St. John, Susan and Stewart, James. Economic concepts and applications. Auckland: Longman. Latest edition.

Callander, Andrew. Understanding the economic environment. Wellington: Butterworths. Latest edition.

#### *Suggested lecturers' references and additional references for students*

Birks, Stuart and Chatterjee, Srikanta (eds). The New Zealand economy: issues and policies. Palmerston North: Dunmore Press. Latest edition.

Dalziel, Paul C. and Lattimore, Ralph. The New Zealand macroeconomy: a briefing on the reforms. Auckland: Oxford University Press. Latest edition.

Easton, Brian. In stormy seas: the post-war New Zealand economy. Dunedin: University of Otago Press. Latest edition.

Heyne, Paul. The economic way of thinking. Upper Saddle River, NJ: Prentice Hall. Latest edition.

Mankiw, N. Gregory. Principles of economics. Fort Worth, TX: Dryden Press. Latest edition.

New Zealand official yearbook. Wellington: Statistics New Zealand. Latest edition.

Pickford, Michael. The economics of markets: a New Zealand perspective. Palmerston North: Dunmore Press. Latest edition.

Scollay, Robert and St. John, Susan. Macroeconomics and the contemporary New Zealand economy. Auckland: Longman. Latest edition.

Stiglitz, Joseph. Economics. New York: W.W. Norton. Latest edition.

Wooding, Paul. Introduction to microeconomics. Dunedin: University of Otago. Latest edition.

Wooding, Paul. Macroeconomics: a New Zealand introduction. New York: Prentice Hall. Latest edition.

#### *Other Publications and Web Sites*

The Reserve Bank of New Zealand Bulletin. [www.rbnz.govt.nz](http://www.rbnz.govt.nz)

Statistics New Zealand. [www.stats.govt.nz](http://www.stats.govt.nz)

New Zealand Treasury. [www.treasury.govt.nz](http://www.treasury.govt.nz)

OECD reports on the New Zealand economy. [www.oecd.org](http://www.oecd.org)

Registered Banks – individual commentaries and indicators

The economist. London. Weekly.

The independent business weekly. Auckland. Weekly.

The national business review. Auckland. Weekly.

## **TIME AND ASSESSMENT SCHEDULE**

The prescription assumes a RCAP model of assessment (R= recall, C = comprehension, A = application, P = problem solving). In assessing to the prescription, it is expected that, in general, assessment will be of the ability of students to apply the learning outcomes and to undertake problem solving within the course material. Assessment of comprehension should be undertaken only where it is appropriate. Assessment of recall is implicit.

TOPICS	Time in hours	Assessment Weightings (%)	
		min	max
1 The Economic Way of Thinking	6	10	15
2 The Price Mechanism	8	10	15
3 Theory of the Firm	10	15	20
4 Evaluation of the Market	6	10	15
5 International Trade	6	10	15
6 The National Economy	10	15	20
7 Government Policy and the Economy	8	10	15
8 Current Economic Issues	6	10	15
	<b>TOTAL</b>	60	100%

This schedule is a recommendation and guide for lecturers, examiners and students. It gives

- 1 an approximate allocation of time in hours by topic
- 2 an approximate percentage allocation for assessment by topic.

## TOPICS

### 1 THE ECONOMIC WAY OF THINKING

#### *Learning Outcome*

At the completion of this topic, students will be able to understand the nature of the economic problem and the various tools that economics provides to analyse the problem.

#### *Assessment Criteria*

Students will be expected to:

- 1.1 Outline methodology for investigating the world of economics, including theory development, simplifying assumptions and model making.
- 1.2 Analyse and show the relationship between scarcity, choice and opportunity cost, and illustrate the economic consequences of these for resource allocation.
- 1.3 Outline the nature of the economic problem (how, what and for whom to produce) and how this problem is resolved in a mixed economy.

- 1.4 Discuss the importance of incentives, economising behaviour and thinking at the margin for economic decision making.
- 1.5 Outline and critique the assumptions underlying firms as profit maximisers and consumers as utility maximisers, and how these assumptions influence behaviour and thus the allocation of resources.

## **2 THE PRICE MECHANISM**

### *Learning Outcome*

At the completion of this topic, students will be able to apply supply and demand analysis to determine price and to recognise the importance of prices in economic decision making.

### *Assessment Criteria*

Students will be expected to:

- 2.1 Discuss the determinants of supply and demand, and the reasons for the downward slope of the demand curve and the upward slope of the supply curve.
- 2.2 Understand, and demonstrate graphically, how supply and demand determine equilibrium prices in a market economy.
- 2.3 Explain the causes of, and analyse the effects of, shifts in supply and demand curves.
- 2.4 Analyse the role of prices in co-ordinating production and consumption decisions and the allocation of resources.
- 2.5 Discriminate between the various elasticity concepts.
- 2.6 Combine supply, demand, and elasticity concepts, and apply them to a range of market situations, including government intervention.

## **3 THEORY OF THE FIRM**

### *Learning Outcome*

At the completion of this topic, students will be able to apply marginal analysis to the pricing and output decision making of the firm under different market structures.

### *Assessment Criteria*

Students will be expected to:

- 3.1 Explain the nature of economic cost, and distinguish economic cost and profit from accounting cost and profit.
- 3.2 Explain and distinguish between short run concepts using the law of diminishing returns and long run concepts using the principle of economies of scale.
- 3.3 Define and calculate the various short-run cost concepts, namely total, average, fixed, variable and marginal costs and explore the long run average cost curve.
- 3.4 Distinguish between the different market states, namely perfect competition, monopoly, monopolistic competition and oligopoly, and discuss the key characteristics of each, including price and non-price strategies.
- 3.5 Define and calculate total, average, and marginal revenue for the firm under both perfect and imperfect competition.
- 3.6 Apply knowledge of economic costs and revenue to organisational decision making behaviour, including short run profit maximisation, the shut down rule and long run entry and exit decisions.

## **4 EVALUATION OF THE MARKET**

### *Learning Outcome*

At the completion of this topic, students will be able to identify and evaluate the strengths and limitations of the market.

### *Assessment Criteria*

Students will be expected to:

- 4.1 Explain and demonstrate allocative efficiency.
- 4.2 Compare and contrast the performance of perfectly competitive and imperfectly competitive firms in relation to allocative efficiency.
- 4.3 Explain the failure of the market to allocate resources optimally, for example the presence of externalities, public goods, common property resources, monopoly power, and inequitable income distribution.

- 4.4 Examine the options of government to resolve at least one of the imperfections in 4.3.
- 4.5 Explain possible government failure in 4.4.

## **5 INTERNATIONAL TRADE**

### *Learning Outcome*

At the completion of this topic, students will be able to evaluate the potential gains from free trade, appreciate why governments sometimes restrict trade and analyse the impact on New Zealand of changes in the global economy.

### *Assessment Criteria*

Students will be expected to:

- 5.1 Discuss the economic reasons for free trade, including the theory of comparative advantage.
- 5.2 Identify the means by which government can intervene in free trade, and evaluate the reasons (economic and non-economic) for such intervention.
- 5.3 Evaluate the economic effects of New Zealand's current policy on trade.
- 5.4 Analyse the changing patterns of New Zealand's trade and New Zealand's international economic relationships.
- 5.5 Explain the way in which overseas transactions are incorporated into the balance of payments and national accounts.
- 5.6 Describe changes in the global economy, and analyse their impact on the New Zealand economy.
- 5.7 Explain the factors that affects the exchange rate and the effects changing exchange rates have on the tradable goods sector.
- 5.8 Outline trade agreements that affect the New Zealand economy.

## **6 THE NATIONAL ECONOMY**

### *Learning Outcome*

At the completion of this topic, students will be able to explain the key issues in the macroeconomy, and demonstrate how changes impacting on the New Zealand economy can be analysed using the Aggregate Demand Aggregate Supply (ADAS) model.

### *Assessment Criteria*

Students will be expected to:

- 6.1 Discuss the importance and measurement of the key issues of economic growth, employment, price stability and balance of payments.
- 6.2 Describe the functions of the basic components of the macro economy (firms, households, financial institutions, government, exporters and importers), and demonstrate how they interrelate.
- 6.3 Discuss the characteristics of each of the phases of the business cycle.
- 6.4 Describe and explain the ADAS model, the key drivers of changes in AD and AS, and the determination of macro-economic equilibrium.
- 6.5 Describe and explain the concept of potential GDP and how this affects the AS curve.
- 6.6 Use the ADAS model to analyse the likely consequences of changes that impact on the economy.

## **7 GOVERNMENT POLICY AND THE ECONOMY**

### *Learning Outcome*

At the completion of this topic, students will be able to analyse fiscal and monetary policy and the way in which government affects the economy through such policy.

### *Assessment Criteria*

Students will be expected to:

- 7.1 Compare and contrast, with regard to recent New Zealand experience, the various goals of fiscal policy, and the ways in which fiscal policy can be used to influence the macro-economy.
- 7.2 Explain the role of the Reserve Bank in formulating and implementing Monetary Policy.
- 7.3 Compare and contrast, with regard to recent New Zealand experience, the various goals of monetary policy and the ways in which monetary policy can be used to influence the macro-economy.

- 7.4 Identify and explain the main transmission mechanisms linking fiscal and monetary policy changes to the economy in both the short and long run.

## **8 CURRENT ECONOMIC ISSUES**

### *Learning Outcome*

At the completion of this topic, students will be able to apply relevant economic models to examine current economic issues and to select appropriate policy options for addressing current economic issues and conflicts.

### *Assessment Criteria*

Students will be expected to:

- 8.1 Analyse and interpret data on the New Zealand economy.
- 8.2 Identify major economic issues facing New Zealand and evaluate alternative policies to deal with one of these.
- 8.3 Explain the difficulty in achieving simultaneously a collection of economic, political and social objectives, and acknowledge the need for government to prioritise these objectives.
- 8.4 Explain the possible conflicts between economic, political and social objectives in both the short and long run.

## **TEACHING NOTES**

### **1 The Economic Way of Thinking**

It is intended that this section introduces students to the question “what is economics all about?”; that is, it is about decision making in relation to resource use given the constraints of scarcity. It is intended that students will appreciate that the tools that economists have developed in order to understand the world of economics have a multitude of applications to the “ordinary business of life” as well as to the more traditional areas of economic science. In examining the mixed economy (refer to assessment criterion 1.3), it is intended that an understanding of the free market economy is established and then the role of government understood in relation to this.

### **2 The Price Mechanism**

The key focus in this section is to firstly use the supply and demand model to demonstrate how a free market economy determines prices in various markets, then secondly to show the vitally important role that prices play as a signaling mechanism to the various decision makers in

the economy. It is expected that elasticity will be explored as a concept, with the calculation of elasticity coefficients available as an optional exercise for use at the discretion of individual lecturers. The material in assessment criterion 2.6 should be approached from the point of view of showing how government intervention can influence price and output outcomes from markets and how this in turn can be expected to influence economic decision making and thus the allocation of resources.

### **3 Theory of the Firm**

It is intended in this section that lecturers use both numerical and graphical illustrations to emphasise the importance of the equi-marginal principle in relation to the decision making of firms. A descriptive treatment of the key characteristics of monopoly, oligopoly, monopolistic competition and perfect competition is required. However, a graphical analysis is only required of the two limiting cases of monopoly and perfect competition. If lecturers wish to add emphasis to this section through a closer look at one of the other market states, they may, at their discretion, include a graphical approach also. The use of actual New Zealand case studies is encouraged.

### **4 Evaluation of the Market**

It is intended in this section to demonstrate that, under certain assumptions or conditions, the free market economic system will deliver an allocatively efficient outcome. However, when these conditions are not satisfied, market failure occurs. This then can be used as a justification for the intervention of government. It must be emphasised, however, that this may also have aspects of failure. Good New Zealand case studies are encouraged to bring this section to life.

### **5 International Trade**

This section is best approached as an application of the principles of microeconomics that have already been developed. For example, comparative advantage as an application of opportunity cost and the supply and demand model to look at whether a country will export or import a given product. The supply and demand model can also be effectively used to consider the impact of trade barriers, their removal and also how the foreign exchange market operates. Furthermore, it provides an opportunity to continue the theme of the efficient allocation of scarce resources into a global context.

### **6 The National Economy**

The focus in this section shifts to the macroeconomy. Students should appreciate the microeconomic underpinnings of the ADAS model and how it can be used to consider the key macroeconomic issues of employment, economic growth, price stability and external balance. Students need to explore how these economic aggregates are measured using the statistical measures of unemployment, GDP, CPI and the

Balance of Payments accounts. There is scope within this section to examine and critique the relative importance of the various issues and the wider impact of these issues in relation to society. Detailed calculations of GDP using various approaches to the measurement of GDP is not required.

## **7 Government Policy and the Economy**

This section aims to provide a degree of historical perspective to the New Zealand economy in relation to the operation of fiscal and monetary policy. Lecturers are encouraged to use the ASDS model to contrast the way in which fiscal policy has been used in the past with a Keynesian stabilisation focus with the way in which it is currently used in relation to budget prudence in terms of the Fiscal Responsibility Act, 1994. Likewise, the way in which monetary policy was, in the past, intended to support fiscal policy through interest rate manipulation may be compared with the present focus on price stability through the Reserve Bank Act, 1989. Students are not required to consider in any detail the nature of money, the banking system or the credit creation process. However, it is expected that they will have an understanding of the settlement process within the banking system so as to appreciate the February 1999 change in the implementation of monetary policy from a quantity based approach (settlement cash target) to a price based approach (official cash rate).

## **8 Current Economic Issues**

Lecturers may, at their discretion, treat this a separate topic or apply the assessment criteria 8.1 – 8.4 throughout the other seven topics of the prescription.