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# 2

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## Level 2 Economics, 2016

### 91224 Analyse economic growth using economic concepts and models

2.00 p.m. Tuesday 15 November 2016  
Credits: Four

Achievement	Achievement with Merit	Achievement with Excellence
Analyse economic growth using economic concepts and models.	Analyse economic growth in depth using economic concepts and models.	Analyse economic growth 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**

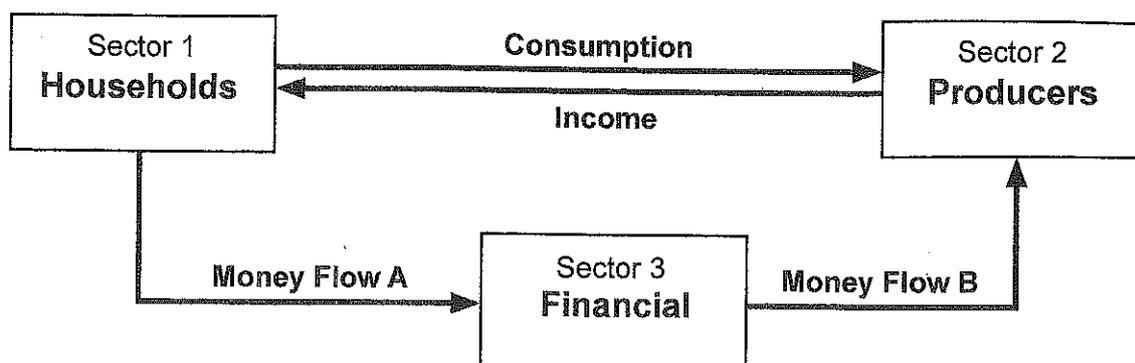
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## QUESTION ONE: CIRCULAR FLOW DIAGRAM

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Model One: Three-sector circular flow model



- (a) Since 2012, the percentage of income that must be contributed to KiwiSaver schemes has increased from 2% to 3%. This would have increased BOTH Money Flows A and B.

Use Model One to fully explain how the increased contributions to KiwiSaver schemes may affect economic growth.

In your answer:

- identify and define Money Flows A and B
- explain how an increase in Money Flow A affects economic growth
- explain how an increase in Money Flow B affects economic growth.

The money flow A is Savings. Savings are given to Financial institutions by households, and are considered to be withdrawals from the economy. This is because households give a proportion of their income to financial institutions instead of using them for consumption etc, and so that money is no longer circulating the economy.

KiwiSaver is a financial institution where households' savings are put. The increase in the percentage of income that is given to KiwiSaver from 2% to 3%, means that the percentage of disposable income left for household consumers is decreased, while the withdrawal from the economy is increased. This results in less consumption spending as the percentage of income available for households to spend decreases, and so their spending decreases. As Consumption is a factor of Aggregate Demand ( $AD = C + I + G + (X - M)$ ) the overall Aggregate Demand will also decrease. A decrease in Aggregate Demand would result in lower economic growth, and the withdrawal from the economy also means a decrease in economic growth as money does not circulate, circulating in the economy is reduced as spending and demand are decreased. The money flow B is Funds for Investment. This money flow is from Financial Institutions to Producers and involves the transfer of funds for Financial Institutions to invest. The increase in savings from households to financial institutions means that Financial Institutions now have more funds to be allocated

Improved economic conditions are expected to cause the Government's operating balance to be in surplus in 2015–2016. It is forecast that this surplus will grow to \$3.6 billion by 2018–2019.

Source (adapted): <http://www.treasury.govt.nz/budget/2015/fsr/05.htm>

Options for the Government on how to use the surplus include.

- reducing income tax rates
- an increase in government spending on education, health, and infrastructure.

(b) Compare and contrast the impact on economic growth of reducing income tax rates with an increase in government spending on education, health, and infrastructure.

In your answer, fully explain:

- the impact of reducing income tax rates on economic growth
- the impact of increasing government spending on economic growth
- why the impact of reducing income tax rates may have a smaller impact on economic growth than increased government spending.

Reducing income taxes would cause an increase in economic activity in New Zealand.

The reduction of income tax would mean that households receive a higher proportion of disposable income as less <sup>is</sup> taken as tax for the Government. This increase in disposable income means that consumption may increase as households now have more ability to demand goods and services. This will cause Aggregate Demand to rise as an increase in consumption will cause AD to increase ( $AD = C + I + G + (X - M)$ ). This increase in Aggregate Demand will cause economic growth to increase as there is a larger amount of money circulating the economy, resulting in an increase in economic activity. Also the increase in Aggregate Demand, may mean that the Real GDP (value of goods and services <sup>produced</sup>) will also increase as supply <sup>may increase to</sup> meet demand. ~~Therefore~~ //

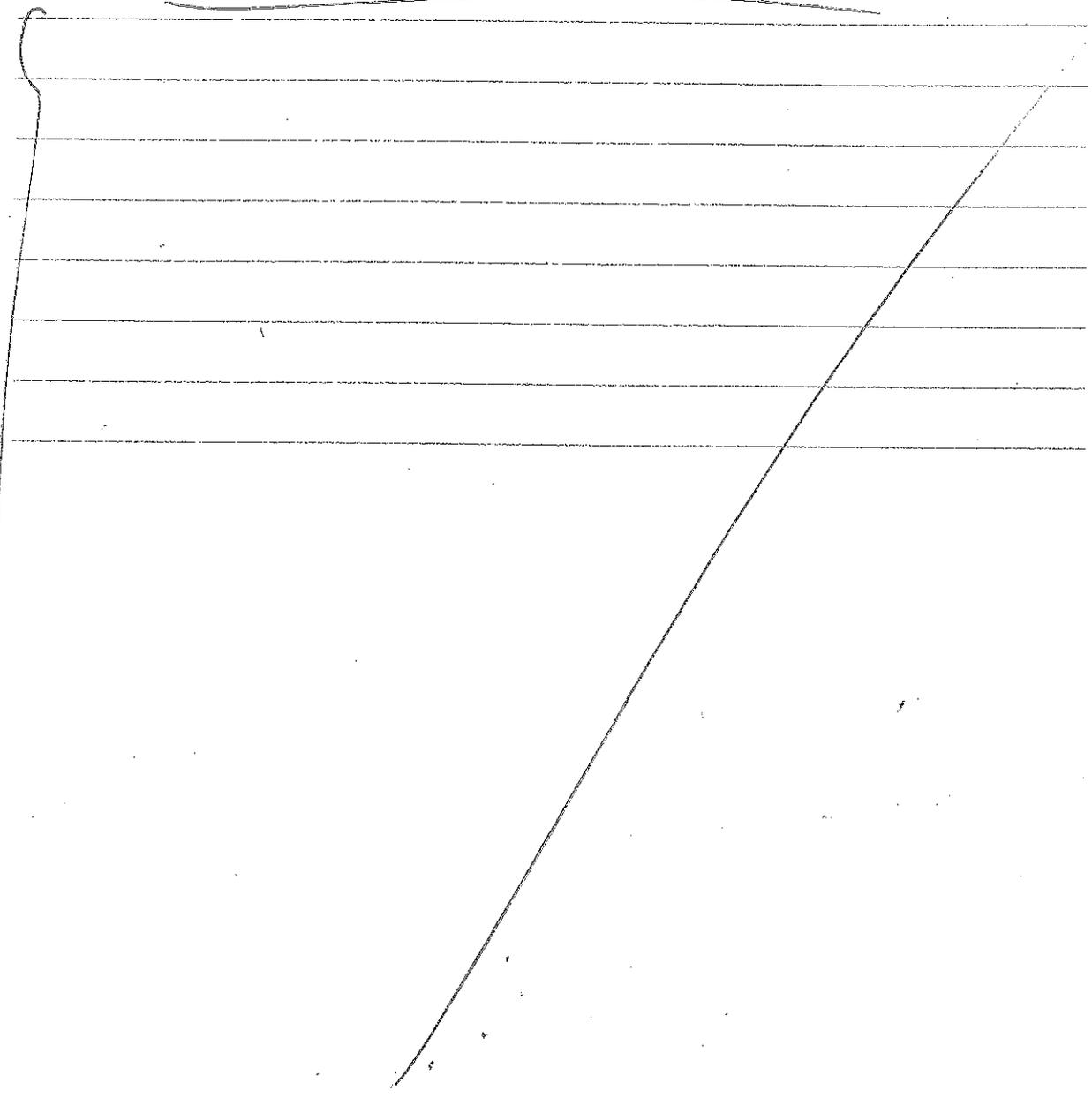
Increasing

Government spending on education, health and infrastructure, will also result in an increase of economic growth. ~~Increasing~~ Spending will cause an increase in Aggregate Demand as Government spending is a component of AD. Like the before, this will cause economic growth to increase as Government spending is an injection into the economy, and therefore more money can circulate the economy. Along with this ~~the economy will~~ the increase in Education <sup>(e.g. grading and transport)</sup> Infrastructure and education especially will allow transport and employment opportunities to increase to lead to greater ~~for~~ production prospects in the future as the ability to gain resources or transport goods becomes easier to achieve.

More answer space is available on the next page.

The impact of reducing income tax is similar to that of increasing government spending because both are injections or reduction of withdrawals in the economy. This means that in both circumstances, there will be an increase in money circulating the economy to allow for increased economic activity. The Real GDP will also increase for both as <sup>ease of</sup> production ~~spans~~ increases, ~~or~~ for spending and for decreased income tax, <sup>increased</sup> ~~the~~ demand encourages firms to increase supply and production by increasing business confidence as the increased demand for all goods and services improves confidence that there will be increased sales //

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## QUESTION TWO: PRODUCTION POSSIBILITY FRONTIER

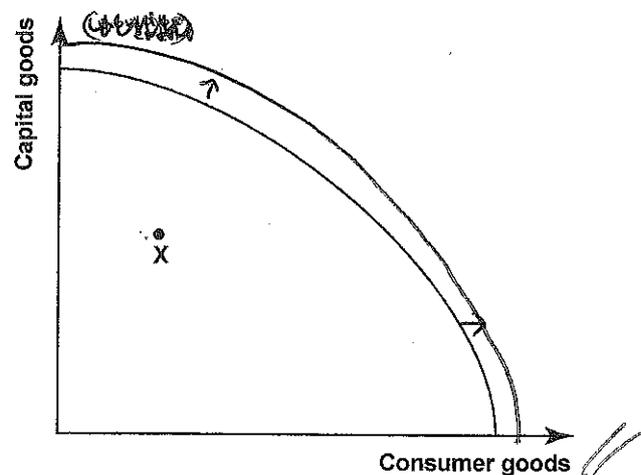
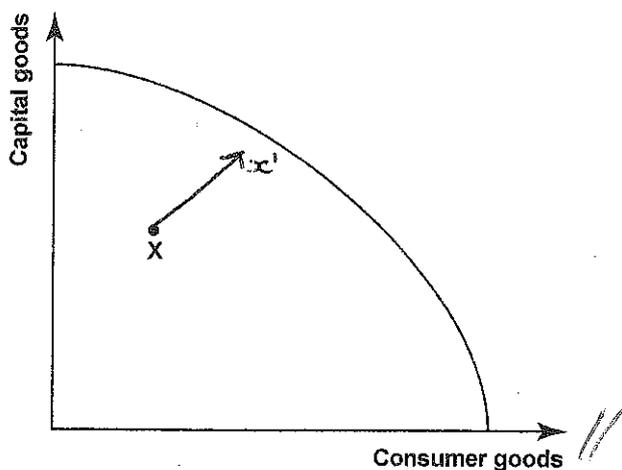
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New Zealand has several occupations and regions in which demand for workers is higher than supply available, even though there is considerable unemployment of suitable workers in the economy. There are two distinct solutions:

- the Government providing job search and relocation assistance to unemployed workers in New Zealand.
- the Government providing incentives for foreign workers to immigrate to New Zealand.

Graph One: Production possibility frontier

Graph Two: Production possibility frontier



**Note:** Point X shows the current combination of capital goods and consumer goods produced in New Zealand.

- (a) (i) On Graph One above, show the impact of providing job search and relocation assistance to suitable unemployed workers in New Zealand.
- (ii) On Graph Two above, show the impact of increasing immigration into the New Zealand economy.
- (b) Use Graphs One and Two to compare and contrast the impact on economic growth of providing job search and relocation assistance to suitable unemployed workers in New Zealand with increasing immigration into the New Zealand economy. In your answer, refer to the concepts of real GDP and productive capacity.

~~the government~~ Providing incentives for foreign workers to immigrate to New Zealand

will increase human labour available for firms to produce goods and services. The increase

in immigration means that ~~the economy~~ there will be more people that are able to work

coming to New Zealand and so the supply of capable labour resources will increase.

~~there~~ This will increase Resources which will shift the production possibility frontier to

the right (Graph 2) and therefore allow the possible production capacity of both

Capital and consumer goods to also increase as there are more resources available to use

in production. An increase in production capacity will mean that if all resources are employed

there will be an increase in the output, and therefore Real GDP, as Real GDP is a ~~measure~~ measure of output. This would result in increased economic growth as the value of goods and services produced will increase. ~~The~~ Increasing the production possibility frontier will ~~at~~ have a positive effect on future economic growth as it gives a higher target to aim toward for firms. This is because there is now more possibility of producing more than before the level of resources was increased and ~~allowing~~ ~~firms~~ encourages firms to continue to <sup>fully</sup> <sup>Progressively</sup> employ more resources in the future to reach maximum potential.

Increasing the provision of job seeking services and relocation for unemployed ~~major~~ people may result in an increase in production and increase productive capacity from where the economy currently sits ( $x$ ) however the level of resources will not change and so unlike ~~the~~ immigration which increased the level of resources in the economy and allowed productive capacity to be increased, the level of resources will remain the same and so productive capacity remains the same. The difference lies in that immigration will increase <sup>the number of</sup> those that are capable of working in the economy and so employable resources will increase and so if all resources in the economy were employed, then the amount of production possible will increase. However helping those that are unemployed but already in New Zealand is not increasing resources - as they are already <sup>part of</sup> ~~in~~ the economy, but it will increase <sup>the</sup> ~~and improve~~ employment of resources. Employing a higher proportion of resources already in the economy will allow production to move further towards the productive capacity ( $x$  to  $x'$ ) (in graph 1), and so the level of consumer and/or capital goods produced will increase from the current situation and further toward what is able to be produced with full employment. This will increase production and Real GDP will increase as the level of output increases, and therefore economic growth increases as well. However it is not as effective as immigration as immigration will allow higher <sup>productive</sup> capacity meaning more capital goods can be produced than before so that the supply of capital goods continues and is optimistic for the future to ensure there are always <sup>sufficient</sup> high levels of consumer goods to be produced to allow more goods and services to continue to be produced in the future, as capital goods are goods used in the production of other goods and

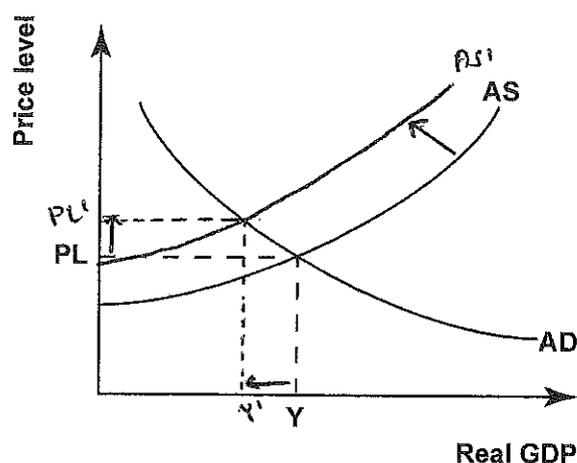
### QUESTION THREE: GOVERNMENT POLICIES AND THEIR IMPACT ON GROWTH

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The Resource Management Act has several objectives, including:

Understanding that present resource use has an impact on the quality and quantity of resources available for future generations.

Graph Three: AD/AS model of the New Zealand economy



- (a) (i) On Graph Three above, show the future impact on the AD/AS model of present-day production permanently damaging or over-exploiting a natural resource.
- (ii) Use Graph Three to fully explain the future impact on economic growth if the Resource Management Act is not enforced and present-day production permanently damages or over-exploits a natural resource.

Permanent damage or exploitation of natural resources means that the supply of this resource will be compromised in the future. Over-exploiting ~~resources~~ may result in this resource being used and damaged before replenishment and regeneration of this resource can occur, and so there will be shortages or complete extinction of the resource ~~in~~ in the future so future generations will have a severely limited to no supply of the resource available. This means in the future all production that involves the use of this resource (for example oil, will be hindered by its lack of preservation, and there will be a decrease in this material. This means the supply of ~~the~~ aggregate goods and services will decrease (AS to AS') either due to not enough resources to produce goods and services or due to increasing costs of the resource due to increasing scarcity and competition and of for the resource, or increased costs to find new resources to be used in production.

This will cause price levels to rise (PL to PL') while the Real GDP will decrease as output in the economy decreases. This results in a decrease of economic growth as Real GDP is a measure of growth.

The 1949 Forestry Act bans the export of swamp kauri logs unless they are made into finished timber products. Exporters have been getting round this with illegally exported logs being processed at their export destination, depriving this country of jobs and the financial benefit of adding value. By [Government's] rigorously enforcing the Act and more closely observing the exporters, the swamp kauri could contribute far more to Northland. This would mean the creation of jobs in a genuine value-added processing industry, making bowls, vases, furniture, and other popular products.

Source (adapted): [http://www.nzherald.co.nz/business/news/article.cfm?c\\_id=3&objectid=11483596](http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11483596)

- (b) Compare and contrast the economic impact of enforcing the 1949 Forestry Act and its value-added policy on extracted kauri logs in the Northland community.

In your answer, fully explain:

- the costs and benefits for workers in Northland
- the costs and benefits for the Government.

Enforcement of the Forestry act and value added policy will have consequences for the Government and workers in Northland. For the Northland workers, more jobs can be created through increased demand for labour in jobs such as furniture making and other manufacturing that are used to transform and add value to the kauri swamp logs. The increase in these employment opportunities in the area will allow <sup>average household</sup> incomes to increase allowing more consumption by these households. ~~Along with allowing more kauri logs to be processed an~~ Increasing average incomes in Northland ~~will also allow~~ through these employment opportunities will allow socio-economic levels in Northland to rise as there will be a larger average income for households. This will also be a benefit to the Government as there are likely to be less transfer payments being made to the area as more people will be earning incomes and will therefore become less reliant on government benefits. Also the Government will receive a higher income tax revenue as more people are receiving incomes, and so the ~~amount~~ <sup>base</sup> are more incomes to be taxed. ~~that will~~ The combination of these two aspects will both increase revenue and Government funds and allow Government spending to increase.

The increase in employment opportunities in Northland will also encourage more settlement in the area as people move to where <sup>opportunities are greater</sup> the employment is in order to find a job. This may be a negative consequence for Northland as infiltration of more workers

More answer space is available on the next page.

and residents will cause more congestion and drive up house prices as more people decide to move to Northland for the employment opportunities. This will put more pressure on house prices as demand <sup>and competition</sup> for property increases, meaning an overall increase in property value. This may also be a positive for some Northland home owners as the value of their property assets increase. However there will be more congestion in terms of traffic etc making travel and the environment worse off as commutes may take longer if more people are on the roads, while a higher concentration of vehicles and will mean higher concentrations of carbon emissions in the area.

The increase in population in Northland will be positive for local businesses as there will be more demand for their goods and services, along with there being an increase in human labour resources to increase productivity and production.

For the Government, ~~more government revenue will be required~~ an increased amount of effort and money may be required to ensure that the act is implemented and

that there is no illegal exporting of kauri logs. ~~this would allow kauri logs~~ This increase in management of the implementing <sup>of</sup> the act ~~will mean~~ ~~that~~ ~~the~~ ~~Government~~ ~~must~~ ~~set~~ ~~aside~~ ~~time~~, ~~effort~~ ~~and~~ ~~budget~~ ~~to~~ ~~allow~~ ~~this~~ ~~act~~ ~~to~~ ~~be~~ ~~successful~~, ~~this~~ ~~may~~ ~~include~~ ~~using~~ ~~some~~ ~~revenue~~ ~~that~~ ~~would~~ ~~otherwise~~ ~~be~~ ~~spent~~ ~~else~~ ~~where~~ ~~to~~ ~~help~~ ~~maintain~~ ~~setup~~ ~~new~~ ~~business~~ ~~in~~ ~~Northland~~ ~~to~~ ~~for~~ ~~furniture~~ ~~manufacturing~~ ~~etc~~ ~~or~~ ~~subsidise~~ ~~these~~ ~~businesses~~ ~~to~~ ~~encourage~~ ~~agreements~~ ~~that~~ ~~deter~~ ~~overseas~~ ~~economies~~ ~~from~~ ~~importing~~ ~~illegally~~ ~~exported~~ ~~kauri~~ ~~logs~~ ~~to~~ ~~be~~ ~~manufactured~~. ~~They~~ ~~may~~ ~~also~~ ~~have~~ ~~to~~ ~~negotiate~~ ~~new~~ ~~trade~~ ~~agreements~~ ~~that~~ ~~deter~~ ~~overseas~~ ~~economies~~ ~~from~~ ~~importing~~ ~~illegally~~ ~~exported~~ ~~kauri~~ ~~logs~~ ~~and~~ ~~instead~~ ~~import~~ ~~manufactured~~ ~~products~~.

However the ability for ~~Northland~~ value to be added to the kauri logs will be a positive for Northland and the Government as revenue for the area will ~~increase~~ <sup>increase</sup> and the value of production (Real GDP) increases as well. This will allow the economic activity in Northland to grow and boost the economy of the area as more employment opportunities occur, and the value of production and revenue from these new products increases. This therefore will benefit the economy as well as benefitting the preservation of the kauri swamp logs.

Extra space if required.  
Write the question number(s) if applicable.

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1a to firms to invest to expand their business or increase assets. The increase in funds to give for investment purposes means that firms are more able to invest to improve technology, resources, develop new products etc. This results in an increase in production and productivity and therefore output is increased. The value of the level of output is measured as the GDP (Gross domestic Product), and which is also a measure of economic growth. The increase in production and output would increase the GDP and therefore economic growth would increase. //

Excellence exemplar for 91224 2016		Total score	21
Q	Grade score	Annotation	
1	M6	<p>Part A. Both flows are identified. Explanation of how savings decreases growth, using consumption. Explanation of how investment increases growth, using examples of capital goods impacting on production. Combining both explanations shows evidence of a detailed Merit explanation.</p> <p>Part B. Both income taxes and government spending are explained, using consumption and productivity (transport), respectively. In the conclusion, an additional impact linking producers indicates a detailed explanation for income tax.</p> <p>Overall, a detailed explanation in Part A and a detailed explanation for income taxes results in two Merit explanations.</p>	
2	E7	<p>Both graphs are correct and clearly labelled.</p> <p>Both graphs are fully referenced in their detailed explanations. There is clear evidence that the candidate understands the difference between real GDP and potential capacity. There is clear evidence of the difference each option has on both economic concepts. There is a minor error in the job search explanation.</p> <p>Overall, both explanations are detailed and there is strong understanding of the differences between each in terms of real GDP and productive capacity.</p>	
3	E8	<p>Part A. A full detailed explanation of why costs of production have increased, causing a shift of AS curve. In addition to referencing to the graph, this is linked to an explanation to why real GDP has decreased.</p> <p>Part B. There is a detailed explanation of the direct benefits to workers in the industry, and indirectly to workers in Northland in other industries, in terms of employment and the benefits of increased income in the region. There is a detailed explanation of the costs to workers in Northland involving cost of housing and congestion. There is a detailed explanation of the benefits to the government in terms of GST and income tax revenue. There is an explanation of a cost to the government in terms of ensuring the law is followed/enforced and a statement this may affect spending in other areas.</p> <p>Overall, there are three detailed explanations in Part B.</p>	