

Assessment Schedule – 2014

Scholarship Economics (93402)

Evidence Statement

Question One

This is an open-ended question, allowing for the discussion and analysis of the role of price signals and the need for government intervention in achieving allocative efficiency in the Auckland housing market.

- In the Auckland housing market, supply had been restricted because of the following factors: anticipation of a collapse in the housing market because of the Global Financial Crisis (GFC), leading to reduced building; the collapse of finance companies in New Zealand meant a significant source of finance was no longer available; low consumer confidence; rising unemployment, resulting in little investment in new housing; rising costs of building and materials; lack of land availability to build on.
- Rising demand for housing has come about because of the following factors: economic recovery from the GFC; historically low interest levels provided cheap credit; inward migration; positive tax treatment for property investors.
- Price elasticity of supply for new housing is highly inelastic in the short run, because of lack of available sections to build on; time required to build new houses; shortage of skilled construction workers, many of whom had migrated elsewhere; small firms dominating the building industry meant low scalability. PED is inelastic because housing is a necessity, lack of substitutes, etc.
- Market model should be drawn to reflect inelastic demand and supply, and show increasing demand leading to a sharp rise in prices.
- As demand increases, temporary shortages will exist; however, consumers will bid up prices until equilibrium is reached. At equilibrium, there will be no deadweight loss, and the market will be allocatively efficient, as consumer and producer surpluses are maximised. The increase in demand results in an increase in producer surplus, because of the increase in price that results. An appropriate market model should be drawn to illustrate these points.
- Rising prices act as a signal to the market to shift resources into providing housing, as increased profitability attracts builders. This is evident in the increase in building consents. A production possibility curve illustrating the shift in resources, and a move along the PPC, should be shown. However, because of limitations on supply of land in particular, and the fact that resources are not perfectly transferable, the transfer of resources will not be immediate – as indicated by the inelastic short-run supply. In the long run, supply can be expected to be more elastic.
- Arguments in favour of the free market achieving allocative efficiency include: if the market is at equilibrium with no externalities, then the market is already allocatively efficient, with prices reflecting existing demand and supply. In addition, the supply of new housing will increase, because price elasticity of supply will increase as the industry is more able to adjust to higher price signals, suggesting market supply will increase in the long run, moderating house prices; sellers will return to the market in response to rising prices, increasing quantity supplied; higher prices will also signal to consumers to restrict quantity demanded, as the market returns to equilibrium – ie rationing the available stock of houses. These responses reflect an allocatively efficient market responding to price signals.
- High housing prices may be seen as evidence of market failure, because of inequitable outcomes, and lack of housing affordability. A contrary argument is that this is an issue of the disparity in the level of consumer incomes, and that it might, therefore, be considered failure in the labour market – or the inequitable distribution of incomes rather than failure in the market for residential houses.
- To argue for government intervention requires evidence or justification that the market is not currently allocatively efficient. Arguments in favour of government intervention, to achieve allocative efficiency, could include: the idea that the supply of land is artificially constrained by regulation. Therefore, deregulation around land supply could improve the efficiency of the market by increasing the PES of land, which affects the rate at which new houses are built; the Reserve Bank's loan to value restrictions might take some of the heat out of the market by restricting the availability of mortgage finance, thus dampening demand to improve affordability; government could increase the supply of (social) housing via a government building programme improving the supply of housing; where a lack of competition in the building supplies industry has resulted in high costs of building, increasing competition could be introduced; reducing the current tax advantages which property investors are reputed to have, by introducing capital gains tax, etc. These measures could all be considered to improve efficiency in the housing market.
- Arguments against government intervention assume the market will respond in the long run, and that government intervention will lead to distortions in the market – which, in themselves, could reduce allocative efficiency in the housing market.
- A justified conclusion should be written.

Note: In this question, the term “housing market” refers to the market for residential property, ie houses.

Outstanding Scholarship	8 Marks	<p>The candidate produces and effectively communicates an outstanding and sophisticated economic analysis of the role of price signals, and the need for government intervention in achieving allocative efficiency in the Auckland housing market, by applying microeconomic theory. This is complete and demonstrates <i>perception and insight</i></p> <p>AND</p> <p>demonstrates <i>sophisticated abstraction and integration</i> of the resource material</p> <p>AND</p> <p>demonstrates <i>independent reflection and extrapolation</i> relevant to the evaluation of the need for government intervention in the market for housing in Auckland</p> <p>AND</p> <p>is <i>convincing</i> and economically literate.</p>
	7 Marks	<p>The essay fulfils most of the requirements above, but contains minor factual inaccuracies (when this affects a statement or opinion)</p> <p>OR</p> <p>deals inadequately with an essential point</p> <p>OR</p> <p>lacks sufficient abstraction or integration of the resource material</p> <p>OR</p> <p>has some minor failure in the evaluation</p> <p>OR</p> <p>may lack some fluency and/or coherence.</p>
Scholarship	6 Marks	<p>The candidate produces and effectively communicates a sophisticated economic analysis of the role of price signals, and the need for government intervention in achieving allocative efficiency in the Auckland housing market, by applying microeconomic theory. This demonstrates a high level of <i>analysis and critical thinking</i></p> <p>AND</p> <p>incorporates a <i>competent level of integration and synthesis</i> of the resource material</p> <p>AND</p> <p>the discussion and evaluation is <i>clear, logically developed, and precise</i>.</p>
	5 Marks	<p>The essay fulfils most of the requirements above, but has some unsupported generalisations</p> <p>OR</p> <p>some major point in the discussion is neglected or incomplete</p> <p>OR</p> <p>has some inadequacy in the evaluation</p> <p>OR</p> <p>ideas may not be communicated effectively.</p>
	4 Marks	<p>The candidate produces a comprehensive analysis of the role of price signals and the need for government intervention in achieving allocative efficiency in the Auckland housing market, by applying microeconomic theory</p> <p>AND</p> <p>produces a <i>clear but undeveloped</i> discussion and evaluation</p> <p>AND</p> <p>demonstrates <i>some level of integration and synthesis</i> of the resource material</p> <p>AND</p> <p><i>demonstrates some application</i> of economic theory relevant to the discussion.</p>

	3 Marks	The answer fulfils most of the requirements above, but is incomplete OR fails to present a cogent argument or make critical analysis OR does not communicate ideas adequately.
	2 Marks	The answer shows limited understanding relevant to the question. Some information is recalled, but ideas are not explained or analysed.
	1 Mark	The answer contains a minimal amount of relevant evidence.
	0 Marks	No response; no relevant evidence.

Evidence statement

Question Two

This is an open-ended question allowing for discussion of the case for introducing a living wage, and evaluation of the advantages and disadvantages of regulating the labour market in this way, compared to other policies.

- Reasons for decline in the returns to labour relative to the returns to capital include: international trade; increasing globalisation and competition from low wage economies, such as China; technology in the form of labour substitution from robots, and automation; efforts to bring about more labour-market flexibility and productivity, particularly deregulation and reducing the power of the unions, have reduced bargaining power.
- The case for introducing a living wage includes: it would allow low-income households to participate more fully in society; real wages have not increased for low-income households; workers at the bottom of the market have been exposed to more deregulation, reducing collective bargaining power and restricting wage increases; it helps to address concerns about the rising income gap between the rich and the poor; a living wage may lead to an increase in productivity due to lower turnover and reduced induction/training costs; provides for a big-city allowance for low-income households.
- The case against introducing a living wage includes: firms are not equipped to assess family circumstances when determining wage rates, so family circumstances will be different for all workers; may increase unemployment because of rising labour costs; relativity issues for those on higher pay, resulting in wage inflation; incomes for low-income households are already boosted by welfare packages such as the Working for Families and accommodation allowances; the free market should determine the wage rate based on labour productivity, so labour market will be distorted if interfered with.
- The labour market model should be used to illustrate the effect of a living wage/new minimum wage being set above the current minimum wage, and the potential increase in involuntary unemployment.
- Reasons for living wage improving outcomes by increasing equity include: reduces income inequality, the Lorenz curve will shift to the left, the Gini coefficient will fall; enables greater participation in society for low-income households, improves social cohesion; less likelihood of social tensions, improved opportunities for families of low-income workers.
- Reasons why living wage will not be effective in increasing equity include: rising costs of employment may lead to rising unemployment, which would increase inequality, especially for low-skilled workers; not sustainable, as it would reduce competitiveness, which could lead to price rises, resulting in no change to real wages.
- Policies other than the living wage that could improve outcomes for low-income workers and their families include: transfer payments, allowances, benefits, subsidies, public provision in the healthcare and education sectors, social housing, universal income, child benefits, reduced incomes taxes for low-income earners, reduced GST on necessities, etc. Candidates should explain and evaluate several policies in terms of their effectiveness in improving outcomes for workers and their families.
- A justified conclusion should be written.

Outstanding Scholarship	8 Marks	<p>The candidate produces and effectively communicates an outstanding and sophisticated economic analysis of the case for introducing a living wage, and an evaluation of the advantages and disadvantages of regulating the labour market in this way compared to other policies, by applying microeconomic theory. This is complete and demonstrates <i>perception and insight</i></p> <p><i>AND</i></p> <p>demonstrates <i>sophisticated abstraction and integration</i> of the resource material</p> <p><i>AND</i></p> <p>demonstrates <i>independent reflection and extrapolation</i> relevant to the evaluation of the case for introducing the living wage, and evaluation of the advantages and disadvantages of regulating the labour market in this way, compared to other policies</p> <p><i>AND</i></p> <p>is <i>convincing</i> and economically literate.</p>
	7 Marks	<p>The essay fulfils most of the requirements above, but contains minor factual inaccuracies (when this affects a statement or opinion)</p> <p><i>OR</i></p> <p>deals inadequately with an essential point</p> <p><i>OR</i></p> <p>lacks sufficient abstraction or integration of the resource material</p> <p><i>OR</i></p> <p>has some minor failure in the evaluation</p> <p><i>OR</i></p> <p>may lack some fluency and / or coherence.</p>
Scholarship	6 Marks	<p>The candidate produces and effectively communicates a sophisticated economic analysis of the case for introducing a living wage, and evaluation of the advantages and disadvantages of regulating the labour market in this way, compared to other policies, by applying microeconomic theory. This demonstrates a high level of <i>analysis and critical thinking</i></p> <p><i>AND</i></p> <p>incorporates a <i>competent level of integration and synthesis</i> of the resource material</p> <p><i>AND</i></p> <p>the discussion and evaluation are <i>clear, logically developed, and precise</i>.</p>
	5 Marks	<p>The essay fulfils most of the requirements above, but has some unsupported generalisations</p> <p><i>OR</i></p> <p>some major point in the discussion is neglected or incomplete</p> <p><i>OR</i></p> <p>has some inadequacy in the evaluation</p> <p><i>OR</i></p> <p>ideas may not be communicated effectively.</p>

	4 Marks	<p>The candidate produces a comprehensive analysis of the case for introducing a living wage and evaluation of the advantages and disadvantages of regulating the labour market in this way compared to other policies, by applying microeconomic theory</p> <p><i>AND</i></p> <p>produces a <i>clear but undeveloped</i> discussion and evaluation</p> <p><i>AND</i></p> <p>demonstrates <i>some level of integration and synthesis</i> of the resource material</p> <p><i>AND</i></p> <p><i>demonstrates some application</i> of economic theory relevant to the discussion.</p>
	3 Marks	<p>The answer fulfils most of the requirements above, but is incomplete</p> <p><i>OR</i></p> <p>fails to present a cogent argument or make critical analysis</p> <p><i>OR</i></p> <p>does not communicate ideas adequately.</p>
	2 Marks	The answer shows limited understanding relevant to the question. Some information is recalled, but ideas are not explained or analysed.
	1 Mark	The answer contains a minimal amount of relevant evidence.
	0 Marks	No response; no relevant evidence.

Evidence statement

Question Three

This is an open-ended question, allowing for discussion of the appropriate objective(s) of monetary policy, and the advantages and disadvantages that arise in using monetary policy to achieve economic objectives, in addition to price stability.

- There are many benefits of price stability for an economy. These include: providing certainty for businesses in terms of planning, thereby encouraging investment; savings retain their value, so saving is encouraged; those on fixed incomes are able to maintain their purchasing power; wage/price spirals are avoided due to low inflation expectations; locally-produced goods remain price competitive with imports; exports remain price competitive in overseas markets; investment in productive rather than speculative assets is encouraged.
- The Official Cash Rate is the main tool of monetary policy, and is used to influence interest rates – and thus, economic activity to maintain price stability. Tight monetary policy may be implemented to contain inflation, but requires raising the Official Cash Rate, which in turn causes retail interest rates to rise. This results in lower consumer spending and investment, and is likely to result in a higher exchange rate, as demand for New Zealand dollars by overseas savers increases. This will have a negative impact on the other macroeconomic objectives. The high exchange rate will have the effect of making exports less competitive overseas, and lowering returns to exporters – while imports will become more price-competitive in New Zealand. As a result, export receipts will decline, while import payments will increase – resulting in a fall in net exports, and a negative impact on the Current Account balance. In addition, reduced net exports will result in a decrease in aggregate demand, as will reduced consumption and investment. A fall in AD will result in an increased recessionary gap (an AD/AS graph showing a decrease in AD, and a recessionary gap would be appropriate). This will, in turn, lead to lower economic growth and increased unemployment. Overall, tight monetary policy has a negative effect on the objectives of economic growth, full employment, and a balanced Current Account.
- Monetary policy could be used to benefit economic growth and employment by adopting a looser monetary policy. Lower interest rates would lead to increased consumption and investment, which would increase aggregate demand, thereby raising the economic growth rate and employment levels (an AD/AS graph showing a reduced recessionary gap would be appropriate).
- Looser monetary policy would also benefit net exports, as lower interest rates would deter international savers, resulting in a lower exchange rate. This will make exports more competitive and imports less competitive, so net exports will improve – moving the Current Account closer to being balanced (a FOREX market and AD/AS graph would be appropriate).
- The disadvantages of using monetary policy to achieve other objectives are that there is a *conflict* in terms of the action the Reserve Bank would be required to take. Looser monetary policy would benefit economic growth, employment, and the Current Account in the short term – but at the expense of rising inflation. In the long term, if inflation is not kept under control, the benefits of price stability would be lost with subsequent negative effects on the economy from reduced savings and investment, reduced export competitiveness, and reduced competitiveness with imports. These effects would, in turn, have a negative impact on economic growth, employment, and the Current Account.
- The advantages of using monetary policy to achieve other objectives in addition to price stability could be a reduced impact on sectors of the economy from tight monetary policy. If the Reserve Bank is expected to consider other objectives as in some other countries, they may choose not to tighten monetary policy as quickly, or may take other action that could reduce the negative impacts on employment, economic growth, and the Current Account.

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	7 Marks	<p>The essay fulfils most of the requirements above, but contains minor factual inaccuracies (when this affects a statement or opinion)</p> <p>OR</p> <p>deals inadequately with an essential point</p> <p>OR</p> <p>lacks sufficient abstraction or integration of the resource material</p> <p>OR</p> <p>has some minor failure in the evaluation</p> <p>OR</p> <p>may lack some fluency and / or coherence.</p>
Scholarship	6 Marks	<p>The candidate produces and effectively communicates a sophisticated economic analysis of the benefits of price stability, and evaluation of the advantages and disadvantages of using monetary policy to achieve other macroeconomic objectives, in addition to price stability. This demonstrates a high level of <i>analysis and critical thinking</i></p> <p>AND</p> <p>incorporates a <i>competent level of integration and synthesis</i> of the resource material</p> <p>AND</p> <p>the discussion and evaluation are <i>clear, logically developed, and precise</i>.</p>
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