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SCHOLARSHIP EXEMPLAR



NEW ZEALAND QUALIFICATIONS AUTHORITY
MANA TOHU MĀTAURANGA O AOTEAROA

Scholarship 2014 Economics

2.00 pm Wednesday 26 November 2014

Time allowed: Three hours

Total marks: 24

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 answer ALL the questions in this booklet.

Resource Booklet 93402R is included in your pack.

Show ALL working.

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 2–28 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.

TOTAL

ASSESSOR'S USE ONLY

This paper consists of three structured essay questions. For each question, use appropriate economic models to illustrate key points, and integrate information from the resource material to support your argument/evaluation.

QUESTION ONE: ALLOCATIVE EFFICIENCY IN THE AUCKLAND HOUSING MARKET

Some people describe the rise of residential house prices in Auckland as a bubble and are concerned about the impact of this on housing affordability.

Use information from **Resources A to H**, and your knowledge of microeconomic theory, to answer this question.

Discuss and evaluate the role of price signals and the need for government intervention in achieving allocative efficiency in the Auckland housing market. Use appropriate economic models to support your answer.

In your answer:

- use the market model and elasticity concepts to analyse reasons for the rise in residential house prices in Auckland
- explain how the rise in residential house prices is likely to affect consumer and producer surplus, allocative efficiency, and the allocation of resources in the market for houses in Auckland
- evaluate whether the free market, or government intervention, is likely to be more successful in achieving allocative efficiency in the Auckland housing market.

Use this space for planning your essay. This plan will NOT be marked.

PLANNING

1. PED - ↑P yet inelastic
so ↑P at v without
much chg in D.

$\frac{\Delta Q}{\Delta P}$
midpoint P%

IEP - luxury / normal good?

$\frac{\Delta Q}{\Delta P}$

reverses? recession?
high Z? low supply
competition

also PQR.
Inelastic right?
few subs
they hit's costy, it's a necessity
inelastic
Supply

C: very elastic
takes long

(low) S high?

Land can't
be "locked"
- reserves
extensivities of
city/dem.

rentals
state to
local est
CPI
factors

Q: ex - esp open ↑
depends on
electricity
(PED)

↑P
open ↑

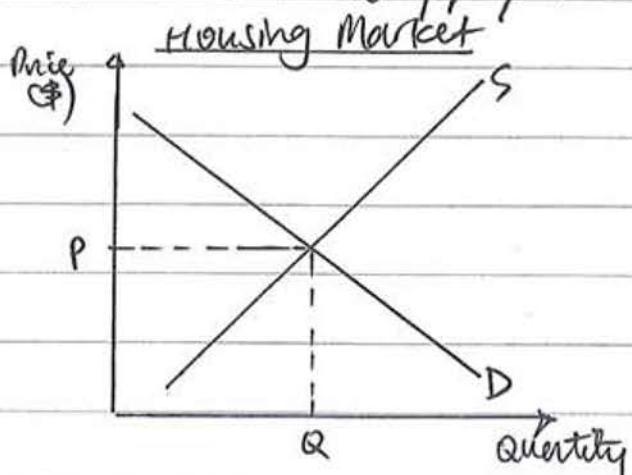
Land can't
be "locked"
- reserves
extensivities of
city/dem.

Begin your essay here.

The rising house prices in Auckland are a definite source of concern. They have been caused by a multitude of factors including elasticity of supply and demand, changes in population and social reasons, and many more, and it can cause many flow-on effects in the marketplace for houses in Auckland. Thus it is an issue that must be looked at to be reduced, through government intervention or otherwise.

The market mechanism ~~is~~^{should be} what allocates much of the Auckland houses in the market. The concepts of supply and demand form the basis of free market (government has no intervention) trade and generally sets the equilibrium market price where supply meets demand

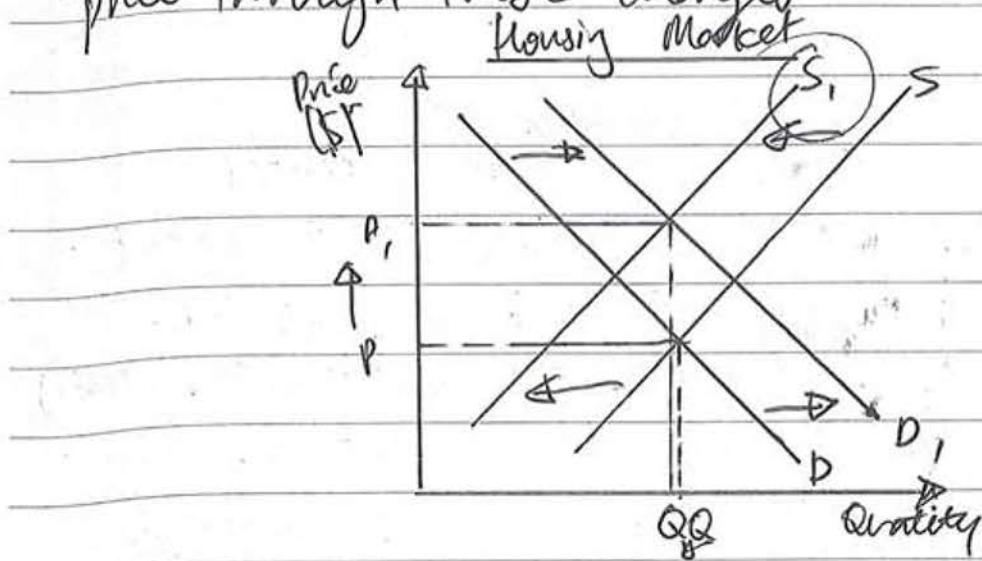
as so:



It can be argued that the price is now so high because of ~~the~~ changes in these two areas.

Demand seems to be rising from non price factors such as Auckland's increasing population, as resource D mentions, predicted to increase to 2 million by

2031. Another factor could be investor speculation and expectations which drives up demand from investment ~~per~~ point-of-view as well as social factors like the social pressure and 'fread' for young people to get a first home, as Resource B points out. As Resource C states, though, the supply has "slowed" which causes the supply curve to shift ~~in~~ and leads to an increased price through these changes:



Though the effect on quantity is uncertain, one thing is clear — this causes prices to be driven up substantially.

It could be argued that this is a 'bubble' as Resource A points out, and this is difficult to categorize. The house prices have definitely accelerated substantially over the past few years in Auckland especially, from a median of \$450k ~~to~~ in 2008 to over \$600k in 2012 as Resource B ~~go~~ pinpoints. This can indicate the presence of a bubble especially as it appears

as the prices are vastly inflated, yet it is difficult to know for sure as the 'debties' has not occurred yet, and this could just be a result of the increased demand and decreased supply, as mentioned above.

Reasons for such a steep increase in price can be partly explained by elasticity concepts, including pure and income elasticity of demand as well as ^{pure} elasticity of supply. Cross elasticity of demand (CED) is unlikely to be a large factor as there are few substitutes for housing and shelter available for people - it would be considered necessary - thus increased demand through the increased price of a substitute is unlikely.

Price elasticity of demand (PED) is the responsiveness of quantity demanded of a good / service to a change in its price. It can be calculated like so:

$$\frac{\cancel{\Delta \text{ quantity demanded}}}{\cancel{\text{midpoint}}} \cdot \%$$

$$\frac{\Delta QD}{\text{midpoint-Q}} \cdot \%$$

$$PED = \frac{\Delta P}{\frac{\Delta Q}{\text{midpoint-P}}} \cdot \%$$

An inelastic PED is where $PED < 1$ and occurs when change in demand is proportionately less

than the price change; elastic demand, or the other hand, occurs when $PED > 1$ and the percentage change in demand is more than that of price. This is determined by many factors, including and PED for the Melkland houses is likely to be inelastic. This is because there are few substitutes for housing available to a person - there is really very little else to shelter oneself ~~and~~ with and live in other than rental housing. Thus as it ~~is~~ has few substitutes and can also be seen as a necessity, demand is likely to be inelastic. ~~But~~ This is in spite of the durability of a house and the high proportion of income spent on housing which would tend to make it more elastic, because they are most essential. This indicates that, as the prices increase, demand does not fall by very much (indeed one could say that demand is ^{high} elasticity the high price changes) and so doesn't solve the problem as ~~it~~ it won't deter many from still purchasing houses. This contributes to the extent of the house price ~~is~~ problem in Melkland.

Also, income elasticity of demand (IED) is another contributory factor that should be taken into account. Because houses are the formula is :

$$\text{IED} = \frac{\frac{\Delta QD}{\text{midpoint } Q} \%}{\frac{\Delta I}{\text{midpoint } I} \%}$$

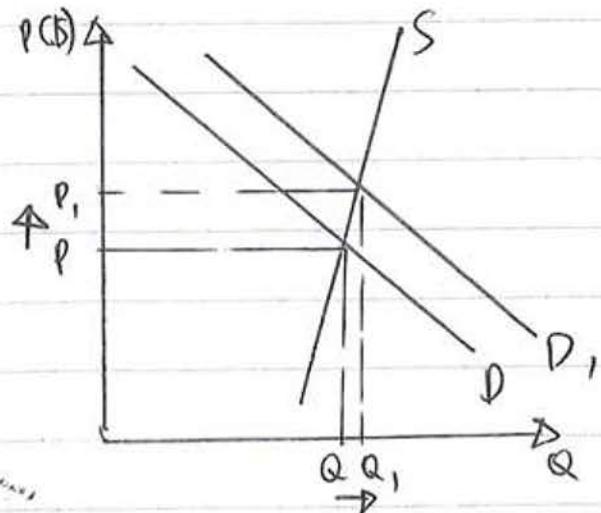
~~As~~ As incomes increase, house prices go up and quantity demanded of houses generally also increases due to the fact that it is a normal good and possibly also a luxury good - as incomes get higher, people want more houses (e.g. beachside baches) or better ones, ^{ones for} or rental investments. Thus, as we exit the Global Recession's effects and economic growth has begun picking up incomes are likely to be rising (though not as high as other countries; as resource F points out) so it contributes to the higher quantity demanded of houses, as normal / luxury goods have a positive IED.

Not only is income elasticity of demand a reason, but also price elasticity of supply (PES) which is calculated as shown:

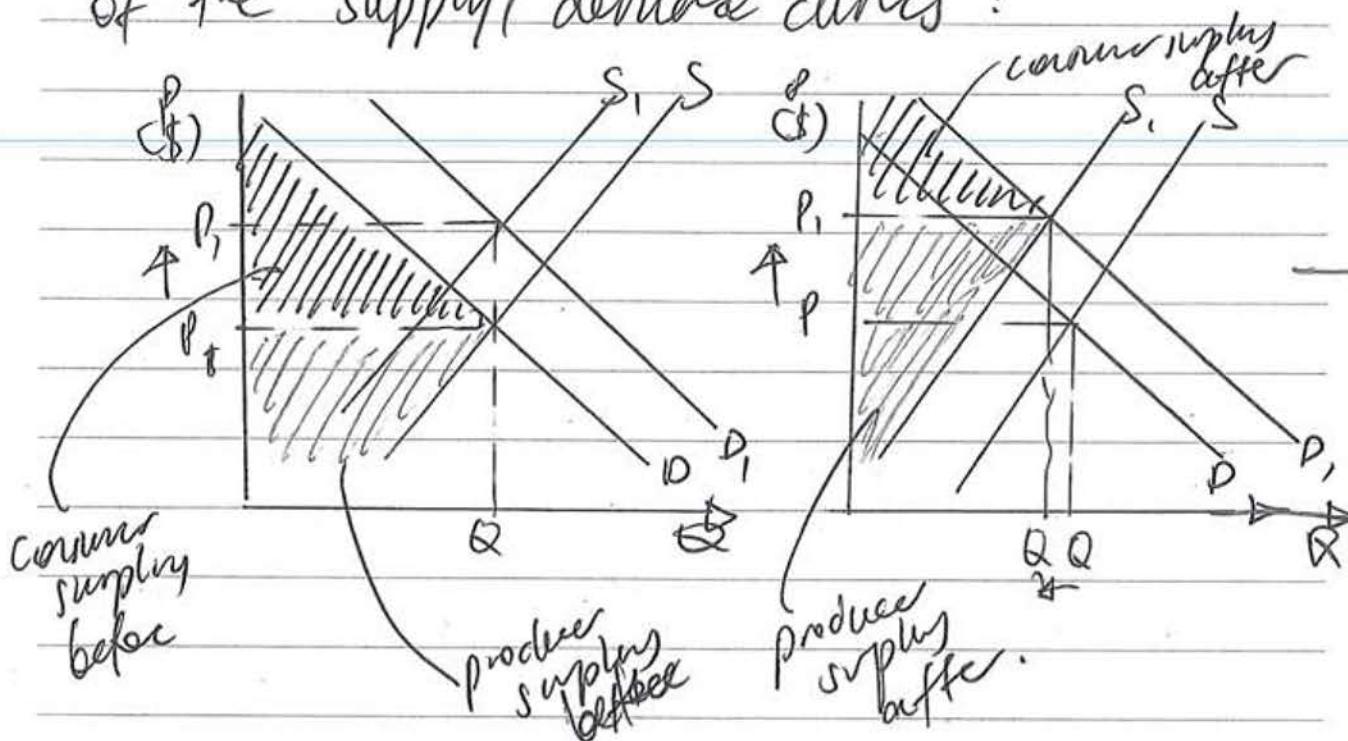
$$PES = \frac{\frac{\Delta QS \%}{\text{midpoint } QS}}{\frac{\Delta P \%}{\text{midpoint - price}}}$$

This measures the responsiveness of the supplies to price changes. For the Auckland housing market this is likely to be

Inelastic ($PES < 1$) as resource C states that the building sector has "traditionally been slow" to respond to the demand. This can be explained by the high long length of time required to build a house, making it very supply & time-consuming, as well as issues such as building contracts and sourcing materials especially as costs are high. Also, land as a factor/resource is scarce and cannot be 'created' - it is difficult to increase supply as it must come from somehow vacant land, from having to demolish reserves/protected areas/forests (which comes with negative externalities) or ~~existing~~ subdividing existing land. Thus supply is highly inelastic and so exacerbates the issue as it doesn't respond much to higher ~~prices~~ demand, so the increase in price is higher as the ^{supply} curve has less of a slope & steep slope due to inelasticity:



This higher price is likely to decrease consumer surplus (extra satisfaction gained) and increase producer surplus (satisfaction gained for one producer). This is due to the shifting of the supply/demand curves:



This is negative for consumers as it decreases their satisfaction even in a completely allocatively efficient free-market situation as it is above. In reality it is unlikely to be truly allocatively efficient, for many reasons. The price rise could be partly caused by a rise in the costs of building materials which is "apparently" 30% higher than in Australia as Reserve Bank states; due to "lack of competition". This indicates a lack of allocative efficiency and thus, market failure - due to the fact market being uncompetitive and not perfect competitive. This means that loss of allocative efficiency

QUESTION
NUMBER

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Write the question number(s) if applicable.

1 efficiency - or "deadweight loss" occurs. The free market economy is thus not allocating resources in the way that best satisfies the consumers' wants, and thus even lower consumer and producer surplus (as producers ~~buy~~ buy factors in ~~noncompetitive~~^{imperfect} markets so "x-inefficiency" occurs and they are worse off).

Overall, this lack of allocative efficiency leads to poor allocation of resources in Auckland's housing market and means that it is not economically efficient, as it is a market "constrained by supply" as Resource E states, due to "resource constraints" and other factors too.

Thus it is worthwhile for the government to look into interventions ~~however~~ as market failure in the free market has occurred. However the effectiveness depends on the ways of intervention. The government could continue increasing interest rates, as they have been doing, however since so that mortgages are expensive and demand falls but price is inelastic.

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Write the question number(s) if applicable.

so it unlikely to deter many buyers. This also applies to a "capital gains tax" - it may not be too effective especially with the ~~conflicting~~ ~~varying~~ demand due to immigrants, first-home buyers and investors. Other ways of achieving allocative efficiency should be explored.

Who will suffer from the tax indeed, but not much. Other ways of achieving allocative ~~demanded~~ efficiency should be explored. State housing could be an option for those who cannot find ~~work~~ due to the shortage but the government rarely has perfect information and they are often causes of shortages too. However, it has its benefits as the government can keep prices down to increase the consumer surplus of the recipients, but ~~and~~ another method could be ~~is~~ ~~with~~ could be more allocatively efficient. Another way they can intervene is by introducing competition into the factor markets which can increase the efficiency by driving prices down due to more competitive firms ~~suppliers~~ (material suppliers) so that supply is higher as costs decrease. This

QUESTION
NUMBER

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can also be helped by the LVR restriction detailed in Resource 6 - it finances the building of houses ~~too~~ and thus decreases costs as well.

Government intervention may be the best way, in this situation, to increase allocative efficiency, as the free market is currently undesirable.

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QUESTION TWO: THE LIVING WAGE

In recent times, rising productivity has created the potential to raise living standards, and yet there have been calls for a 'living wage' to be introduced because the minimum wage is considered inadequate.

Use information from Resources I to N, and your knowledge of microeconomic theory, to answer this question.

Discuss the case for introducing a living wage, and evaluate the advantages and disadvantages of regulating the labour market in this way, as opposed to other policies to improve outcomes for workers. Use appropriate economic models to support your answer.

In your answer:

- explain why the returns to labour have fallen relative to the returns to capital, including changes in productivity, international trade and labour market deregulation
- explain the case for and against the introduction of the 'living wage'
- evaluate whether or not the introduction of a living wage is likely to be effective in increasing equity
- describe and evaluate policies, other than the living wage, that could also improve outcomes for workers and their families.

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PLANNING

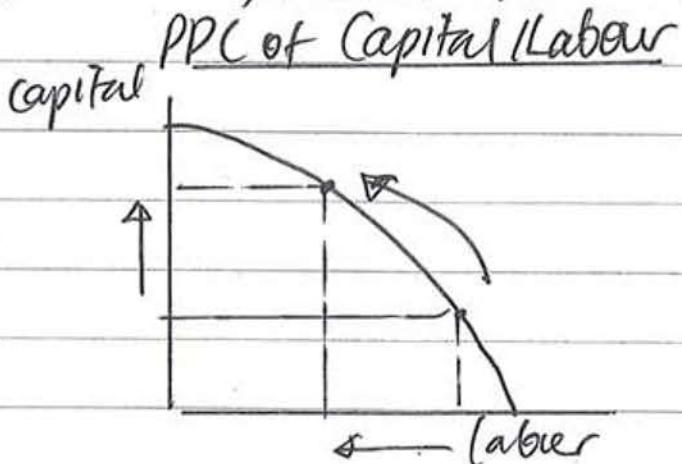


unemployment

Begin your essay here.

A living wage is a concept that is heavily debated. Many people agree and disagree with this way of the minimum wage to a more 'livable' one. There are many causes to this idea, as well as many consequences or alternatives that may be explored.

Labour has had falling returns compared to capital as evident in Figure 1, as the "labour share of national income has been falling" across much of the world as seen in the graph as the lines trend downward. This is partly because of productivity — capital has become more productive due to technological advances which accounts for about "80% of the drop in labor share" as research development has made returns on capital higher and thus owners substitute more labour towards capital, as shown, with their resources:



Furthermore, international trade is also a factor as globalisation and increased free trade across

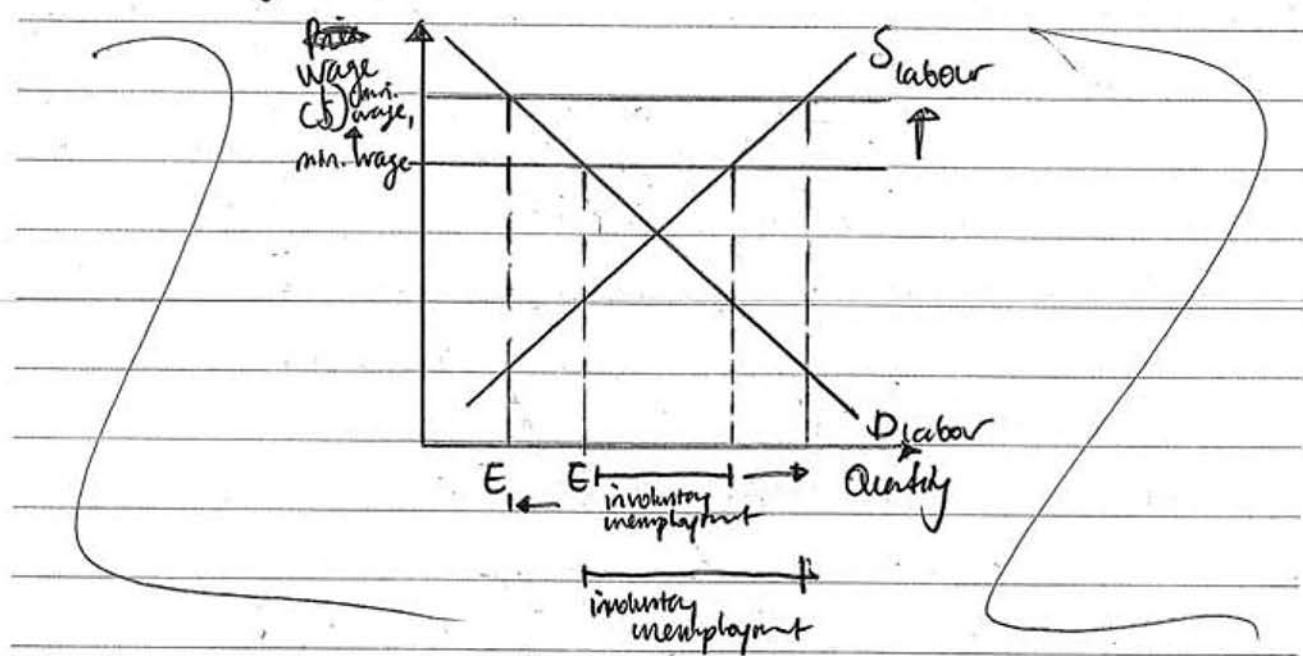
borders has caused a lot of outsourcing from companies. Firms outsource jobs to countries where the labour is cheaper (usually due to higher purchasing power of money) for them^{comparative market wages here} so that their costs are minimized. This causes growing unemployment in the home country and ~~higher~~ thus the labour share of national income falls. This doesn't mean that the worker who is 'cheaper' is benefiting either, though, as they also suffer from the effects of substitution towards capital. Furthermore, labour market deregulation causes wages to fall too as it increases the competition within the labor market which is more economically efficient yet leads to dropping labour shares - bad for the social welfare of the workers as their incomes decrease, as the competing workers are theoretically 'price takers' who cannot negotiate due to competitiveness.

Myth: there is a case for a 'living wage' so that labour does not attempt to have low ~~wages~~ declining wages. The case for this is that people should get enough to live a "decent" family life and to "take part in society". This highlights the concern of the government with the welfare of the people as a primary issue over the higher costs. Another concern is that the minimum wage has been

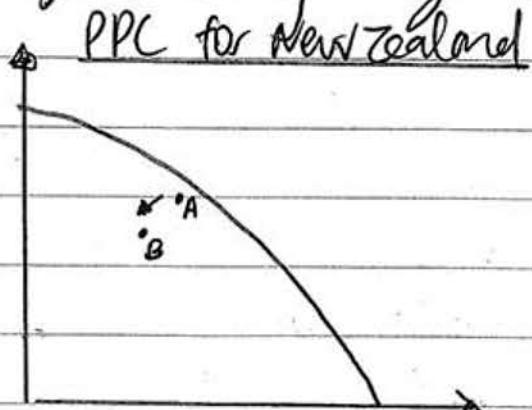
"eroded by inflation", suggesting that the nominal wage is not increasing to keep pace with the increase in the consumer price index, thus the real wage (or 'purchasing power') is decreasing, their people are slowly worse off as they can afford ~~as many~~ to buy things anymore. Thus it is beneficial to increase it more so that living standards are not dropping. Furthermore, it could be argued that the increased wage will not increase unemployment substantially, as markets aren't perfectly competitive. This holds as markets like oligopolies are examined: they tend not to be operating at minimum cost and can then afford to raise wages without decreasing amount of people employed. A market like this is a monopoly market e.g. Terra - it ~~is~~ the dominant buyer (or employer) in the market so can afford higher wages and higher employment thus better welfare for employees.

Yet there are also opposing arguments. It is plausible that this will increase costs for businesses, thus decreasing competitiveness and decreasing supply of goods/services too as costs of production increase, which is detrimental to the economic growth of the

economy as a whole. It can also lead to higher unemployment as shown:



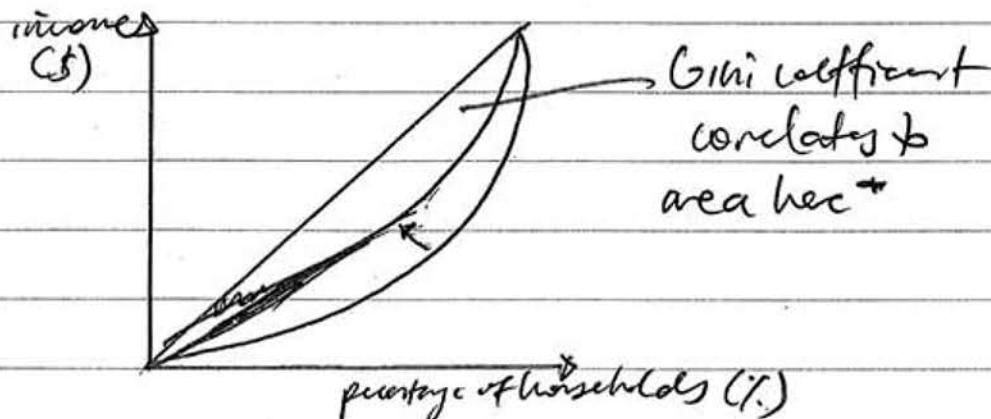
This shows that involuntary unemployment (where the person is ~~actively~~ willing and able to work at the present wage but can't find employment) increases and thus thus increases the inefficiency to the economy as well as the amount ~~people~~ the government must spend on welfare (unemployment benefits) as the mandatory, higher living wage is initiated.



As inefficiency is increased due to more unemployed resources this is detrimental. Another argument against is that ~~over~~ this

concentrates the costs on employers instead of making society (and the government) responsible for ~~them~~ supporting people through benefit/transfers, which can be argued to be unfair to employers, as ~~it is~~ it is costly - for Auckland council workers will cost a "\$3.75m per year" ~~above extra~~ first for them. Also, it is difficult to determine the situations /needs of a worker - they may not need that much to live" e.g. a high school student at home with parents working a job. This this leads to tax/taxes inefficiency.

Introducing this living wage of \$18.40 may increase equity. Equity is "fairness" and if this improves income ~~&~~ inequality as workers are paid more it could decrease New Zealand's Gini coefficient as shown in the Lorenz curve:



This thus decreases inequality as the economy gets closer to the ~~100%~~ 45° "perfect equality" line (though it is unattainable ~~but~~ practically). However, it could

be argued that it doesn't improve equity-fairness. The workers may not be producing an output that is worth \$18.40 per hour and thus it is unfair to pay them that much, and not equitable. Furthermore, it's possible that if unemployment were to increase as a result, more people will require government assistance and have to live on much less, thus increasing inequality and inequity. Thus it is unlikely it will increase equity by very much due to the dampening effects of unemployment and inefficiently high costs.

Other policies, then, should be taken into account when considering ~~the~~ the implementation of this living wage. It is suggested that the business should pay the existing wage or ~~over~~ the free market wage and have the government pay the rest that the person needs. This has benefits as it doesn't put pressure on the business and its competitiveness in order to sustain the workers, and thus increases efficiency. Government assistance can be personalised and targeted - whether it is because the person has a family to support or is sick ~~or~~ or needs accommodations, the government can tailor the benefits so that the business doesn't have to pay a universally high wage on the assumption that that's what they need. It also splits

the costs to society as it comes from taxes — which everyone has to pay. However, this may mean that taxes get higher for the average citizen which can decrease their welfare and lead to ~~the~~ social dissatisfaction too as people may not support the policy. Also it may lead to an opportunity cost — the money may have otherwise been spent on healthcare or education and thus a trade-off is needed which can lower the quality of other government services. Not only this but the government may misallocate the money that 'tops up' to a living wage — this would lead to higher inefficiency, for example if they overestimated the amount needed for a parent to support his/her family ~~and~~ and thus someone else received not enough — meaning allocative inefficiency.

The 'living' wage is a ~~of well intentioned~~ concept that may not be wholly practical in its application to the New Zealand ~~more~~ economy. Therefore, it is important to consider heavily other policy tools ~~before~~ as well and ~~possibly~~ reach a compromise between the advantages and disadvantages.

QUESTION THREE: MONETARY POLICY OBJECTIVES

Monetary policy in New Zealand has the sole economic objective of achieving price stability.

Use information from Resources O to U, and your knowledge of macroeconomic theory, to answer this question.

One Suggs

Discuss the importance of price stability for the New Zealand economy, the impact that monetary policy can have on other macroeconomic objectives, and evaluate the advantages and disadvantages of using monetary policy to achieve macroeconomic objectives in addition to price stability. Use appropriate economic models to support your answer.

In your answer:

- explain the economic benefits of price stability
- explain the effect that changes to monetary policy can have in terms of achieving other macroeconomic objectives. BOP, growth, employment.
- explain how monetary policy could be used to achieve macroeconomic objectives other than price stability. short term
- evaluate the advantages and disadvantages of using monetary policy to achieve other macroeconomic objectives, in addition to price stability. conflict

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PLANNING

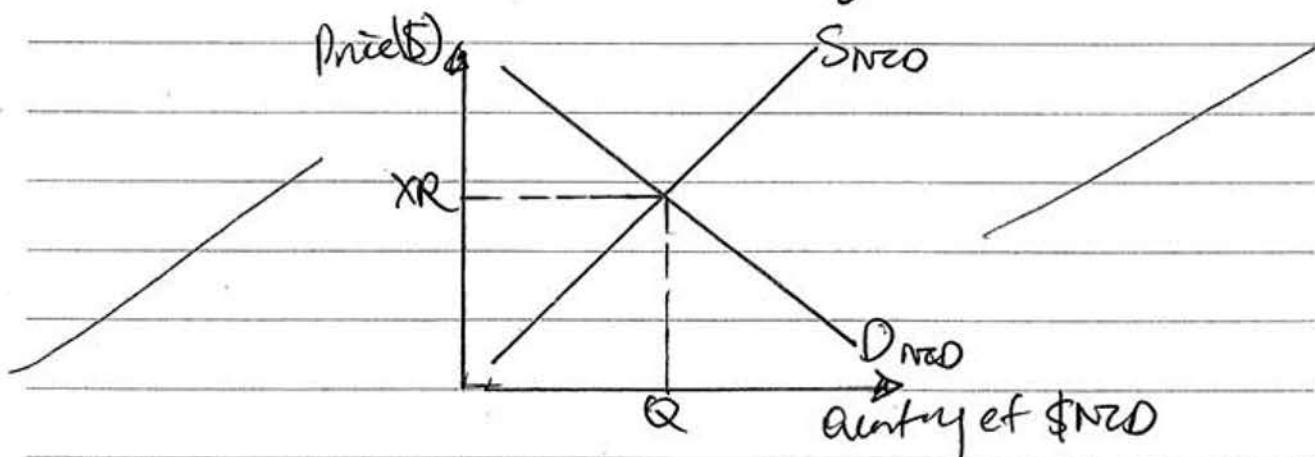
or the amount they can purchase and many that hard-earned savings are also worth increasingly less. Though ~~stable~~ price stability often refers to inflation, deflation is another bad occurrence - it means that people are less inclined to spend (as prices will drop in the future) so it slows economic growth as AD decreases since $AD = C + I + G + X - M$. (and C decreases).

In this way, it's important to have a stable price level - the target is 2% inflation as Resource O states. This ensures that there is enough inflation to encourage spending and growth, but stable enough to make the economy ~~not~~ grow more sustainably ~~but~~ with less fluctuations. Price stability is thus the basis for many other objectives.

Changes in macroeconomic policy ~~alone~~ a wide range of can achieve other objectives other than price stability also. As Resource P mentions, it can have an effect on the exchange rate. For example, if the government ^(increases) ~~decreases~~ the interest rate at a time where the New Zealand Dollar is ~~droopy~~ ir valuable, this attracts foreign demand for the \$NZD as they wish to deposit "carry money" into our banks as they'll earn a higher rate of interest back. This pushes up the \$NZD's value.

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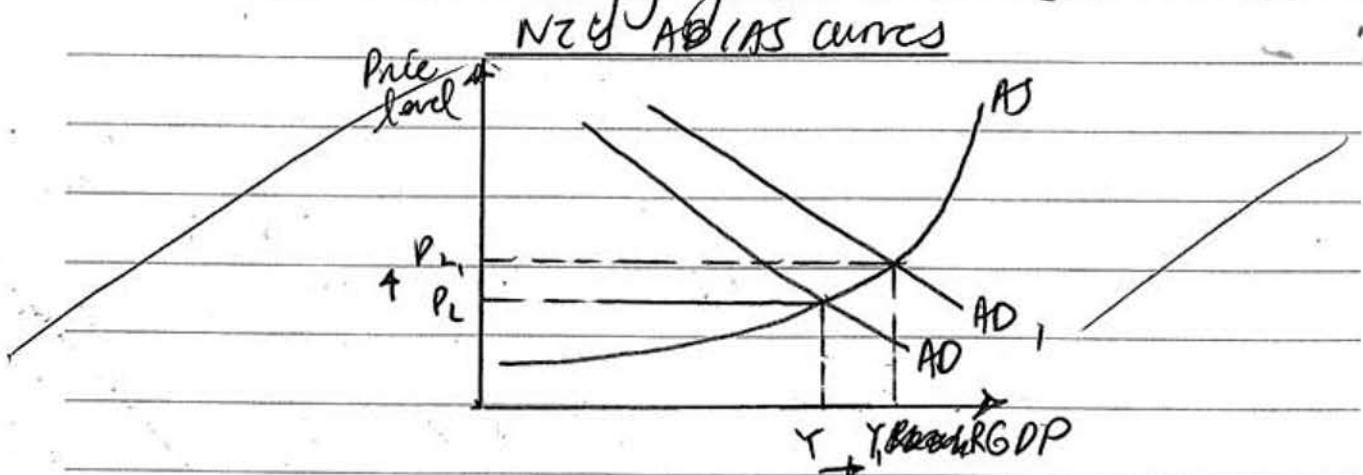
value again, contracting the devalue in value and continuing to stable exchange rates. This can possibly affect the macroeconomic objective of a balanced current account of the Balance of Payments such that export receipts equals import payments so that we can maintain and balance the demand ~~for~~ for imports and exports by influencing the exchange rate through monetary policy (if \$NZD is low, ^{NZ} exports are generally more demanded as they are relatively cheaper to the foreigner and imports if NZ are less demanded due to higher relative prices and lower purchasing power of our currency), and thus changing the free market for the exchange rate:



If they can increase export demand through influencing a lower exchange rate by the interest rate, this can be beneficial to the economic growth as an objective because ADG aggregate demand increases as export receipts increase (though this depends on,

²²
Balance of Payments as we traditionally see it
~~The elasticity of demand for exports~~, deficit, so we may
get closer to achieving ~~a~~ balanced current account.

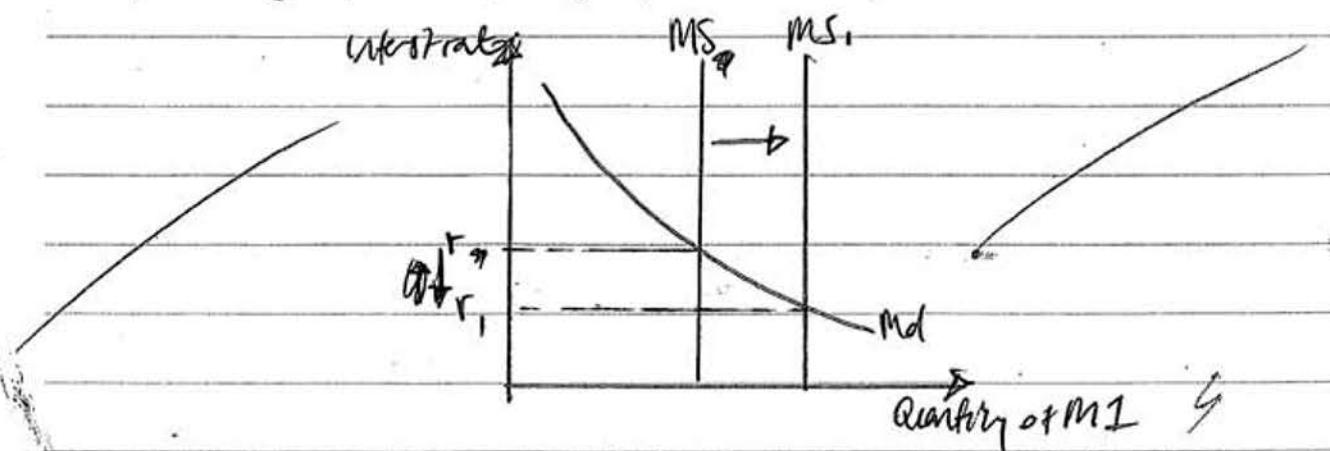
Another macroeconomic objective the government can use ~~the~~ monetary policy to influence is economic growth. This is arguably the most important objective as it increases welfare in the economy as Real GDP increases. Interest rates can be decreased to increase aggregate demand as $AD = C + I + G + X - M$. Low interest rates encourage consumption spending ($C \uparrow$), investment spending ($I \uparrow$) due to cheaper credit/loans, thus cheaper to ~~spend~~ spend and invest. As it decreases interest rate, as discussed, exports are also boosted while imports are negatively affected in terms of demand. This aggregate demand increases:



~~Real GDP increases, boosting economic growth. This also leads into another macroeconomic objective of full employment~~
higher output due to economic growth leads itself to higher employment generally, as people are employed to be making of those goods.

This could also be influenced with another monetary policy device, 'forward' or moral suasion — by the reserve Bank giving many announcements / predictions about what they 'will' do to the interest rate, it can influence people to do the same things (e.g. invest more) due to expectations of future occurrences without actually changing the interest rate — though the effectiveness is limited.

Furthermore open market operations (OMOs) can also influence objectives like economic growth. They occur when the government buys/sells bonds to the public to influence the money supply and thus alter demand ~~for~~ AD. For example, if the government ^{bought} bonds to the public, they ^{increase} ~~decrease~~ the money supply as they ^{give no public} ~~receive~~ more money. This drives ~~up~~ down interest rates as shown in the Keynesian liquidity preference graph:



and this can influence the economic growth/AD as it ~~also~~ also has the effect of lowered interest rates and is thus another monetary policy tool.

However there are ~~dis~~ advantages and disadvantages of these policy instruments to achieve other objectives.

Advantages include the effectiveness of monetary policy - interest rates can be a very effective determinant / influenced of spending / investment / exchange rates and thus on objectives like BOP balance, economic growth and full employment. Also, the ~~po~~ objectives can be cohesive - for example, price stability can help preserve the value of money and thus form a good basis for economic growth which leads ^{us} closer to full employment - thus, the objectives can be very simultaneously achieved.

However there are also drawbacks - there may be conflicts of interest through using monetary policy as a multi-faced tool. If ~~the economic growth of AD is~~ too high this can lead to inflation as price level rises, albeit on definitely,

~~This~~ conflict with the objective of price stability as the target is 2%. — it may be higher. Yet, to ~~do~~ increase interest rates to maintain price stability can cause a dampening of AD — and thus, lower economic growth, conflicting with this. This 'balanced' approach can also lead to ~~this~~ a conflict between using monetary policy for stable prices and for stable exchange rate as well and thus a more 'balanced' approach can actually be harmful to all areas as the Reserve Bank tries to do everything with it, ~~they~~ nothing is done well.

For these reasons, it is important that monetary policy be considered a tool to influence these other objectives but to keep firmly 'price stability' as the number one objective of monetary policy, as similar to European Union policy, as Reserve Bank points out. ~~though~~ It is also ~~of~~ plausible that price stability itself is the basis of the other goals as it keeps the economy predictable and sustainable, thus other policy instruments (e.g. fiscal policy for government tax/expenditure) should be used ~~as~~ primarily for other objectives.

Scholarship

Question One

A good introduction is provided (pg 3), and the factors leading to the increase in demand in the Auckland housing market are identified (pg 4). The candidate appears to confuse the Auckland housing market with that of the construction industry, as the supply curve is shown as shifting to the left. The arguments presented would have been better used to support the argument that the price elasticity of supply curve is very inelastic.

Elasticity concepts were discussed (pg 5). It was sufficient to discuss PED and PES, and thus the use of CED and YED had less relevance. The candidate was able to integrate and synthesise resource material to correctly identify PED and PES as inelastic and the diagram on the bottom of page 8 clearly shows this inelasticity impacting on the Auckland housing market as the increase in demand leads to a considerable increase in price.

The analysis on the effects on CS and PS and allocative efficiency (pg 9) was confused by the attempt to show the decrease in supply. Even though the candidate argued for government intervention to correct for the ‘deadweight loss’, the essay provides reasonably convincing arguments for how the government could intervene, identifying the use of higher interest rates and the Capital Gains Tax (pp 26–28) to reduce the demand and explored some of the ways government could increase the supply of housing.

Overall, the essay is judged to have reached Scholarship standard, but makes some unsupported generalisations and has some inadequacy in the evaluation, thus it does not reach the standard for Outstanding Scholarship.

Question Two

The candidate provides a competent explanation of why returns to labour are falling (pp 11–12) integrating information from the resource material effectively and giving relevant economic analysis to expand upon the resource material.

The candidate outlines some arguments in favour of a regulated living wage (pp 12–13) but does not go into detailed explanation. Reference is made to imperfectly competitive markets (pg 13); however, the argument provided is somewhat jumbled.

The candidate outlines arguments against a regulated living wage (pp 13–15) but again the discussion lacks depth. A well labelled labour market graph is included, but is only briefly referred to – this could have been the basis of more detailed analysis.

The candidate outlines the pros and cons of the living wage regarding equity and recognises the potential contradictory effect on income inequality and therefore equity (pp 15–16), as well as recognising the possible disconnect between the new wage rate and the value of the work produced by a worker – this shows a sound level of economic analysis and perception.

The candidate provides a reasonable and economically literate discussion of an alternative approach to the regulated living wage (pp 16–17) recognising the advantages and disadvantages that could apply.

Overall, the candidate has covered many of the key points that were important to the question and has shown that they are capable of a reasonable level of economic analysis and critical thinking. Their answer is relatively clear, concise and logically developed so meets the criteria of Scholarship. To meet the standard of Outstanding Scholarship greater detail and depth of analysis is required to better develop the economic arguments regarding the living wage.

Question Three

The candidate clearly explains two advantages of price stability (pp 19–20): the concept of price stability meaning that businesses can make better predictions about the future and that this will therefore lead to an increase in business confidence and investment, and the idea that deflation will lead to a decrease in consumption and that this will lead to a decrease in aggregate demand and therefore lead to a decrease in economic growth.

The candidate gives a basic explanation of how monetary policy is used to achieve price stability (pp 20–22). The explanation does contain some errors and omissions such as:

- Idea that the government is responsible for setting interest rates is incorrect.
- Candidate has not explained how the RBNZ, through changing the OCR, can influence interest rates.
- Candidate could have shown a decrease in aggregate supply on the AD/AS model (caused by an increase in costs of production from more expensive imports).
- A FOREX model could have been included to show the impact of a change in interest rates on the New Zealand dollar.
- The paragraph on open market operations on pp 23–24 was not required, as the RBNZ no longer uses this method to influence interest rates.

The candidate gives a brief explanation of how monetary policy can be used to achieve an increase in economic growth and an increase in employment.

The paragraph covering the idea of a conflict between the different macroeconomic objectives (pg 24) was part of the evaluation required for a Scholarship answer.

The candidate could have discussed the short term and long term impacts of using monetary policy to achieve price stability. This could have been included to improve the grade to an Outstanding Scholarship.

Overall, the essay is judged to have reached Scholarship standard, but required more in-depth analysis and evaluation in places to improve the grade further.