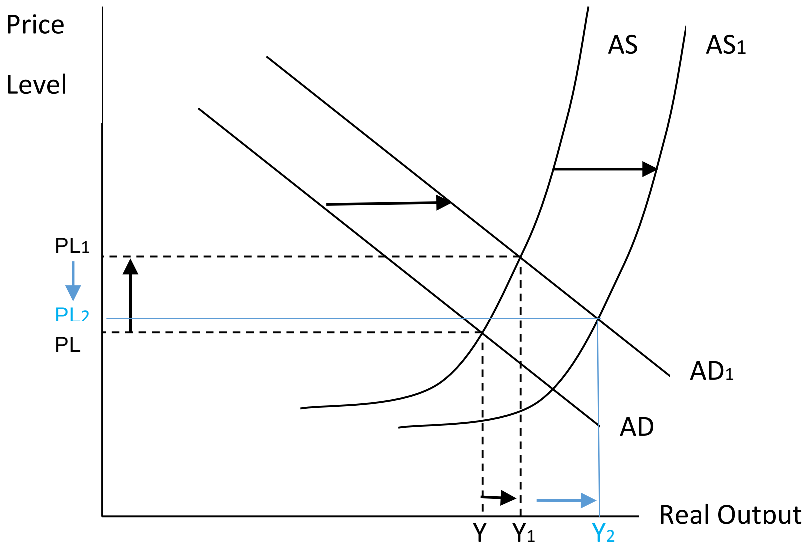
Significant and Sustainable Economic growth: Sustainable economic growth is about actions taking place in the present that will cause economic growth, but does not diminish the prospects of future generation's level of consumption, wealth, and utility or welfare compared to the people in the present. Sustainable economics takes greater account of the social and environmental consequences of growth strategies. For example, sustainable economic growth will consider if the strategy for growth causes any environment damage or resource depletion. Significant growth relates to closing the gap between NZ and Australia. 13

Policy 1: Increase subsidies for firms involved in emerging, sunrise industries (fiscal policy) e.g.… 16
This means there will be an increase in government spending because (G) is a component of AD, so this will increase aggregate demand AD = C+G+I+(X-M) which means the aggregate demand curve shifts right from AD to AD1. This will cause an increase in price level from PL to PL1 and real output from Y to Y1. An increase in real output means there is an increase in economic growth.

This will also increase aggregate supply (AS to AS1), because a subsidy reduces the firms costs of production. The price level will fall (PL1-PL2) and the real output would increase (Y1-Y2). this will increase economic growth and lessen cost-push inflation.

Policy 2: Increasing the OCR (contractionary monetary policy) will encourage people to save money, as it is profitable for them, but the cost of borrowing has increased, because interest rates have increased. People are encouraged to save instead of spend so there will be a decrease in consumption spending (C), and mortgage payments will now be more expensive. Any increase in savings will make more funds available for investment by firms. However, interest rates would need to decrease before firms would borrow for investment.



This will cause a decrease in aggregate demand, which will shift the aggregate demand curve left from AD1 back towards AD. This will help counteract the demand-side inflation from policy 1, and will negatively affect real output a little, but the increase in AS increases Y1 to Y2. As the increase in real output caused by aggregate supply shifting right is greater than the decrease in real output caused by decreased AD, there will be an increase in real output overall. As the price level decreased and the real output has increased, there will be an increase in economic growth. 14

Policy 3: Decrease the tax on imported raw materials (supply-side fiscal policy)… 16
This will cause an increase in aggregate supply, which means aggregate supply will shift from AS to AS1. This happens because firms are able to produce more as the costs of production have decreased. Cost of production decreased as the tax on imported raw materials decreased and therefore firms are able to buy the same amounts of raw material at a lower cost.

This makes an increase in aggregate supply and will cause the price level to decrease (PL1 to PL2) and real output to increase from Y1 to Y2. The increase in real output also means that there is an increase in economic growth.

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Combined flow-on effects on inflation: Increase subsidies for firms. This means there was an increase in government spending (G). This will increase aggregate demand (AD = C+G+I+X-M) which means the aggregate demand curve shifts to the right from AD to AD1. This will cause an increase in price level from

PL to PL1. The price level increased and therefore there was inflation. However, the shift of aggregate supply to the right was much greater than the shift of aggregate demand to the right, so overall the level decreased which means there was deflation, as seen in the graph below PL-PL1-PL2.

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Increasing the OCR and therefore interest rates will encourage people to save money rather than borrow money as the cost of borrowing has increased. People are saving instead of spending so there will be a decrease in consumer spending (C). This will cause a decrease in aggregate demand, which will shift aggregate demand curve to the left. This will cause a fall in price level back towards PL.

Decrease the tax on imported raw materials. This will cause an increase in aggregate supply, which means aggregate supply will shift to right. This happens because firms are able to produce more because the costs of production have decreased. This improves efficiency, which will increase aggregate supply and will cause the price level to decrease. Therefore, overall there is a decrease in price level from PL to PL2, so there was deflation.

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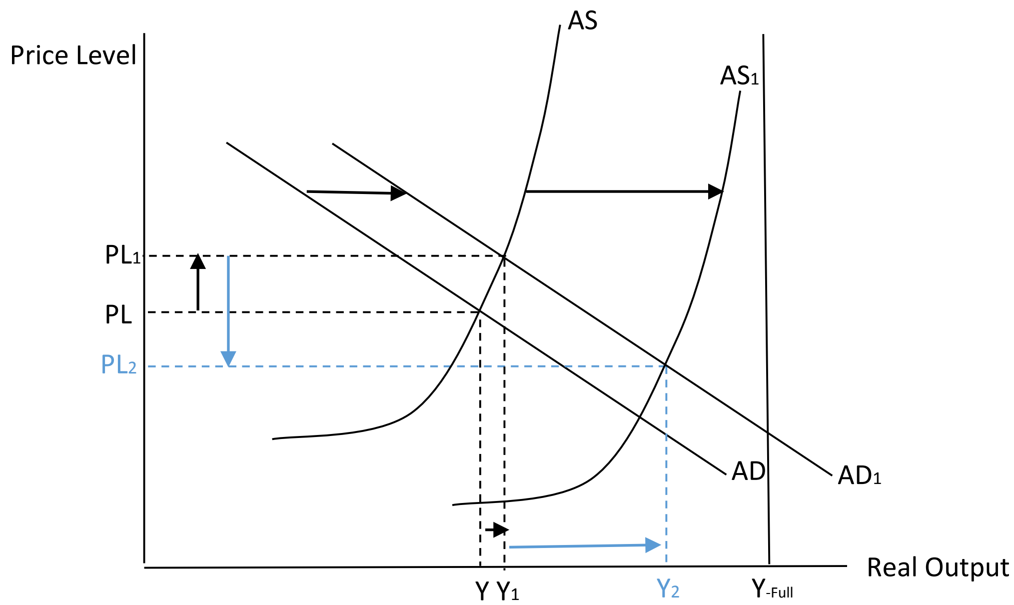
<u>Combined flow-on effects on employment</u>: As the equilibrium has shifted closer to Y-Full, this suggests there was an increase in employment. As increasing the OCR, decreasing tax on imported raw materials



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and increasing subsidies for firms caused an increase in real output from Y to Y2, which means there was an increased need for more workers, and improved efficiency. As (G) and (C) has increased, firms will have to employ more people to work because firms may not be able to produce at full capacity without more staff and therefore firms' demand for labour increases. As more people are employed, the unemployment rate will decrease and the employment rate will increase.

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Summary

These policies show significant economic growth, as the graphs above show a significant increase in real output which means efficiency has increased significantly. The increased subsidy for firms, firstly, increased aggregate demand, as it is government spending, and therefore increased price level a bit making sure that the price level was not too low, and also increased AS because costs of production decreased. Secondly, contractionary monetary policy helped to ease short to medium term inflationary pressure, and thirdly, decreasing the tax on imported raw materials would increase aggregate supply by lowering the costs of production and lowering the price level while increasing real output, and creating economic growth and more employment. This means that in the long-term households will have more disposable income and this will decrease the income gap between NZ and Australia.