Introduction

The specific policy objectives are to reduce the unemployment level from 6.2% in 2013 to 4.5% in the next two years, and to increase real growth (RGDP) from 2.5% in 2013 to 4% in the next two years. Some of the growth in nominal GDP can often be attributed to demand-pull or cost-push inflation. Therefore, the combination of government policies needs to be able to achieve real growth and employment while minimising any negative impacts on inflation and the balance of payments (current account). 1

Policy 1: Infrastructure Spending (roading, rail systems, broadband, and construction in Christchurch)
Policy 2: Re-Training of workers
Policy 3: Better Management of Welfare Benefits

[Student explained the three policies above in detail, presenting accurately labelled models, and changes shown on the AS/AD, Labour market, and PPF models were integrated into the explanations of the short-term direct impacts and long-term flow-on effects of the policies].

Policy Package Summary

The package of policies I have provided work together to increase employment levels. The first policy, increased infrastructure spending will cause more jobs to become available in the industries such as construction and retail. The second policy will retrain and upskill workers who were previously unemployed, and provide incentives for firms to hire these people. The third policy addresses the welfare system and forcing long-term unemployed people to participate in re-training programs and find employment. Together the policies increase the participation rates, increase the amount of available jobs and reduce unemployment. 2

All three policies have a potential effect on labour prices. Supply and demand of labour determine the wage rates. Each policy increases employment, so there are more workers in the work force. This means the participation rate increases in all cases. The first policy, to increase infrastructure-spending causes businesses to re-open to satisfy increased demand for products – meaning more workers are needed so demand for labour increases. The second policy to re-train workers, matches the greater amount of workers needed by providing incentives for firms to employ and train people.

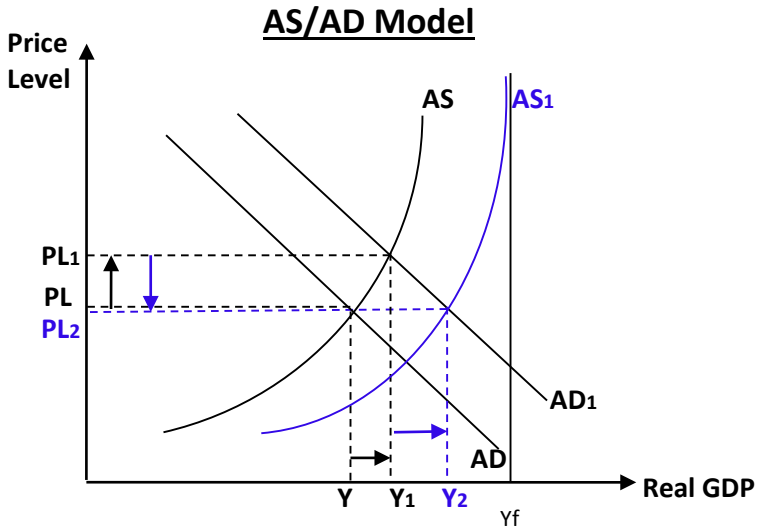
The third policy manages welfare spending better, and creates jobs by providing firms with more control over how many they can afford to employ – meaning firms are more willing to employ workers and demand for labour increases. It is arguable that a change in participation rates, or change in the size of the labour force shifts the SL curve. For example, if the availability of welfare support decreases the SL curve would shift right, increasing the supply of labour. 2

Selecting these types of fiscal policies increases the likelihood that retrained workers and those seeking employment can find jobs. If supply and demand of labour increases then the change in the wage rates will depend on the proportional shift between the SL and DL curves. For example, if workers are retrained in an industry that did not have a large demand for workers then the shift in supply will be proportionally greater than the shift in demand for labour, resulting in a lower wage rate. This is why it is important that industries with skill shortages be primarily focused on by government for the retraining and upskilling incentives.

The policy package has a positive effect on the balance of payments. The increase in infrastructure spending in Christchurch will increase tourism export earnings longer-term and the spending on various projects means an increase in AD to AD1. The amount of goods and services produced will increase, so Real GDP will increase from Y to Y1. This reduces unemployment, moving the economy closer to full employment (Yfull). 2

Retrained and upskilled workers may be employed by exporting industries and less unemployment means more disposable income. This does mean there is the potential for demand of imported goods to increase. Families who may have previously struggled to make ends meet would spend their higher wages on wants like technology and cars, and this would decrease the balance of payments.

However, it is likely that the increased exports of goods and services will help offset the increased imports of consumer goods.
The balance of payments will benefit from the fiscal policies and any short-term negative effects of increased incomes on AD are outweighed by the significant benefits each policy provides in the long-term on AS and Real GDP. 2



All of the policies increase the price level of goods and services. The first policy causes a shift in AD and demand-pull inflation. The second and third policies also increase AD in the short-term as seen on the model PL to PL1, but have beneficial effects longer term on AS. Retraining and upskilling workers will improve productivity, and better roading and rail services will lower firms' costs of production. There is a shift in the AS curve to AS1 and a decrease in price level from PL1 to PL2, therefore an increase in Real GDP from Y to Y2, moving the employment level closer to Yfull. 2 Additionally, better workers with new skills, and faster technology e.g. broadband will improve firms' efficiency and future productive capacity, shifting the PPF curve outwards.

To minimise the impact on price level, an additional policy added to this package is contractionary monetary policy used by the Reserve Bank to counteract the negative effects of inflation. The OCR would be increased and therefore interest rates would increase, *consumption falls as the cost of borrowing increases for households and firms, and inflationary pressure would drop, maintaining price stability between 1-3% as defined in the Policy Targets Agreement. 3

Any increase in the OCR has to be moderate to avoid any long-term detrimental effects on exports, investment and consumption. Because DL is formed from the demand for final goods and services and could threaten employment levels (derived demand). The higher exchange rate lowers the cost of oil and other imported materials, reducing firms' costs of production, so AS increases and reduces inflationary pressure further (no cost-push inflation). However, our exports lose price competiveness and demand for NZ goods overseas will decrease, negatively affecting AD and the balance of payments, and the employment level because we rely heavily on export earnings to increase our Real GDP. 3

The long-term benefits of the fiscal policies should still outweigh any short-term adjustments made to the OCR to maintain price stability in the short to medium term. I believe implementing policies that re-develop cities like Christchurch, solve skill shortages, increase productivity, and decrease the poverty gap will improve the quality of New Zealander's lives by increasing the employment levels, wage rates, and improve the balance of payments because of a significant increase in Real GDP growth.

Example of integrating the AS/AD model into the additional policy: …*consumption falls as the cost of borrowing increases for households and firms, because AD = C+I+G+(X-M).
Falling (C) and (I) due to higher interest rates will decrease AD1 back towards AD and demand-pull inflationary pressure would drop from PL1 back towards PL in the short to medium term, or this policy counteracts the short-term inflationary effects of the fiscal policies and therefore price level may remain relatively constant around PL. 4