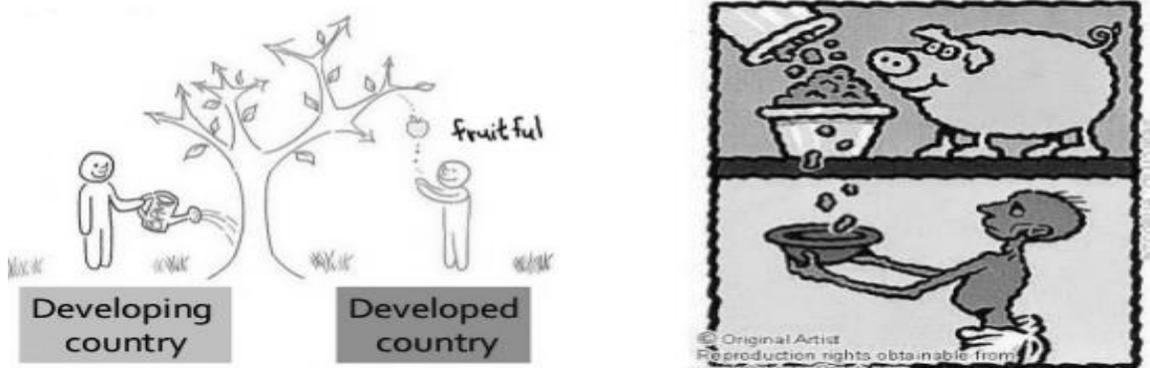


**Exercise # 1: Economic Growth and Development**

1.

## Developing Economies Facing Problems



- a. State ONE problem that is facing by a developing economy.
  - b. With close reference to an example of a developing and developed country that you have studied in class, compare the characteristics of your two countries in terms of Investment to GDP, Foreign Investment to GDP, and saving to GDP.
2. Study the statistic data below and answer the questions that follow.

Total population	103,252
Labour force	24,456
Foreign aid (Australian Aid)	\$28.8 million
GDP per capita	\$7,738
Remittances	\$17.78million
GDP	\$799.3million

- a) Use one example of economic indicator from the information in the table above to describe Tonga is a developing country.
- b) Calculate the ratio of foreign aid to GDP
- c) Life expectancy and education are primary indicators of a developed country. Use these two indicators to evaluate the Tonga economy. In your answers, explain:
  - The features of these two indicators that is seen in Tonga economy.
  - The importance of these indicators to economic development of Tonga economy.

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**Exercise # 2: International Trade and Payments.**

Number of workers to produce one kg

	Kava	Sugar
Country A	15	8
Country B	13	17

a) Calculate the opportunity cost of producing kava and sugar for each country.

Country A :

Country B:

b) Name a country that should specialise in producing Kava and sugar

Kava : \_\_\_\_\_ Sugar: \_\_\_\_\_

2.

“The era of globalization has seen a rapid increase in the degree of international trade and financial integration”. *Scott Davis (Vanderbilt University)*.

a. Define international trade.

b. State ONE benefit of a country involving in international trade.

c. Identify One type of trade protectionism exist in Tonga’s economy.

3. Two islands, Reef and Sandy Islands, with the same resource endowment, and producing taro and kumara, are considering trading with each other. They need your advice on what they should produce for export. The table below shows their level of production if they specialised in either taro or kumara. Use the information to answer the questions that follow

<b>Products</b>	<b>Reef Island</b>	<b>Sandy Island</b>
<b>Taro (kg)</b>	500	200
<b>Kumara (kg)</b>	1000	800

a. Using an example from the table, define the economic concept of absolute advantage.

b. Which country has comparative advantage in taro production? Clearly show all workings and explanations.

c. Which country has comparative advantage in kumara production? Clearly show all workings and explanations.

d. Which country should specialise in taro production and hence export taro?

e. Give a reason for your answer in d.

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**Activity # 3**

1. Calculate the Terms of Trade if the Export Price Index is 125 and the Import Price Index is 116.
2. Which of the following would result in an improvement in the Terms of Trade?  
A. Improvement in the balance of payments.      B. Increase in the price of exports.      C. Increase in the price of imports.  
D. Reduction in export quota.
3. Use the information below to answer Questions 3 to 5. Balance of payments account for Tropicana Merchandise exports \$20m Merchandise imports \$41m Invisible balance \$23m Capital account balance \$18m Overseas reserves \$20m  
3. The Current Account balance for Tropicana is:  
A. \$11m surplus      B. \$21m deficit      C. \$29m surplus      D. \$49m surplus
4. Overseas reserves would change by:  
A. \$9m      B. \$21m      C. \$29m      D. \$49m.
5. Which economic event is not included in the invisibles section of the Balance of Payments?  
A. Services      B. Transfers      C. Borrowing      D. Investment income
6. Use the information below to answer questions (a) to (c). The European Union agreed to grant some of the Pacific Island countries millions of Euro for school, technical / vocational, health and sanitation projects..... (Source: Islands Business, September 2002)
  - a. Explain two economic effects of this grant to the Pacific Island countries.
  - b. State one problem of foreign aid to Pacific Island countries.
  - c. Differentiate between foreign aid and foreign investment.
7. Pacifica's Foreign Exchange Rates for the months of May and June 2003.  
May 2003 : PD \$1.00 = NZD\$0.85 June 2003 : PD \$1.00 = NZD\$0.83  
Note PD - Pacifica Dollar NZD - New Zealand Dollars
  - a. What has happened to the value of the Pacifica Dollar over the period shown above
  - b. Which currency is stronger?
  - c. Given your answer to (a) above, describe the effect of the trend on: (i) exporters of crops from Pacifica to New Zealand.
    - ii. Pacifica's Balance of Payments.
  - d. How the exchange rate is determined in a regime that uses the Floating Exchange Rate System?

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8. Pacific Island Countries currently face trade problems. Most of them cannot compete in the international market thus leading to a rise in trade deficit.
  - a. Explain the effects of trade deficit on
    - (i) local industries.
    - (ii) Employment
  - b. What is the role of the International Monetary Fund with regards to trade problems in the Pacific?
9. The price of one Country B dollar in terms of Country A dollar changes from \$.009281 to \$.008657.
  - (a) Explain whether Country A's dollar depreciated or appreciated against country B's dollar.
    - c. Calculate the corresponding prices of Country A's dollar in terms of Country B's dollar.
    - d. If Country A's dollar depreciated against Country B's dollar. What effect would this have on Country A's visible exports?
    - e. Give **ONE** negative economic effect of a current account deficit.
    - f. Suppose both Country A and Country B practice Fixed Exchange Rate regime. Explain how a Fixed Exchange Rate regime operates.
10. Critics of the World Trade Organization (WTO) argue that Pacific Island Nations (PIN) international trade competitiveness is at greater risk under a full membership status of WTO.
  - a. Identify **TWO** risks to Pacific Island Nations Balance of Payments.
  - b. Define **Current account** and give **ONE** example of a major export commodity from your country.
  - c. Trade in the South Pacific Region is supported by various trade agreements and marketing boards and agencies.
  - d. Give **TWO** examples of trade agreement.
  - e. Explain how the trade agreement would benefit the exporting sector in your country.

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**Activity # 4**

1) The NZD to TOP exchange rate on Saturday 27<sup>th</sup> of August, 2016 was as follow:

$$1 \text{ NZD} = 0.85 \text{ TOP}$$

- a. Name a country that has a weak currency from the exchange rate stated above.
- b. The information above is being determined by floating exchange rate.  
 Define the meaning of **floating exchange rate**.
- c. Describe how exchange rate on Saturday 27<sup>th</sup> of August affects the Tongan importers
- d. Suppose that your parents want to buy a new laptop from New Zealand for your studies. The cost of Toshiba laptop is NZD \$900. Calculate how much TOP\$ that your parents would need to spend on purchasing this laptop from New Zealand.
- e. Discuss the impact of the exchange rate of TOP against NZD on the Balance of Payment of Tonga economy.

2) **Balance of Payment**

	<b>TOP\$ Thousand</b>
Export of goods	26007
Import of goods	336922
Income from foreign investment	13508
Import of services	128325
Income from investment abroad	23379
Export of services	13521
Inflow of current transfer	94893
Outflow of current transfer	2327

- a) State the components of the Balance of Payment Account.
- b) Calculate each of the following components of Balance of Payment.
  1. Balance of Trade
  2. Balance of Current account
- c) Explain the effects of the results of current account on the domestic economy.
- d) Describe how appreciation of Tongan Pa'anga can influence the Balance of Trade

**Activity # 5**

- 1) Describe capital account as a component of balance of payment account.
- 2) Study the data given below for a hypothetical economy.

**Balance of Payment for Beta Economy (extract)**

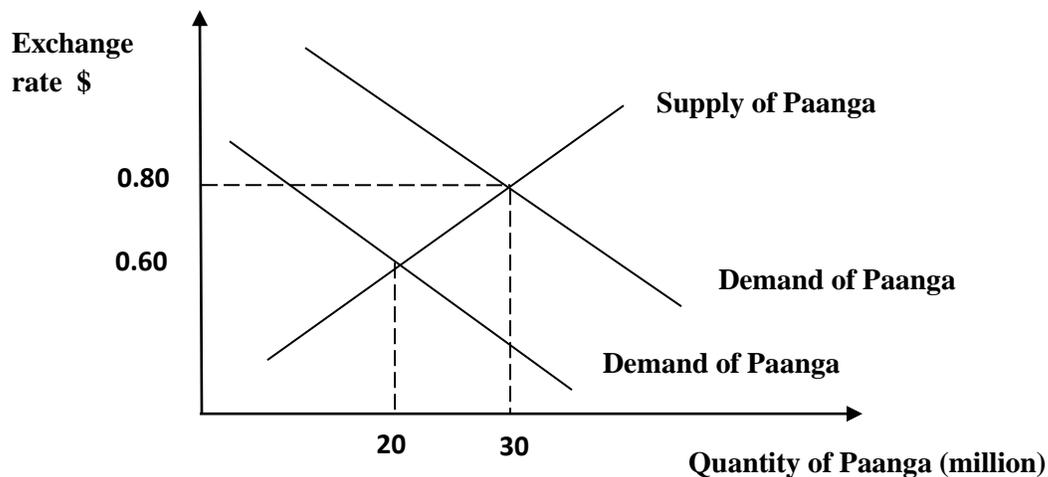
Details	\$ million
Net exports of goods	850
Net invisibles	700
Balance of capital account	1250

- a) Calculate: (i) Balance of current account.  
(ii) Overall Balance of payment.

3)

“The era of globalization has seen a rapid increase in the degree of international trade and financial integration”. *Scott Davis (Vanderbilt University)*.

- a) Define international trade.
  - b) State ONE benefit of a country involving in international trade.
  - c) Identify One type of trade protectionism exist in Tonga’s economy.
  - d) State ONE argument in favour of the identified trade protection in (c).
- 4)



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- a) State the determinant of the exchange rate system illustrated in graph 2.
  - b) With reference to Graph 2, state the situation of Pa'anga in terms of American Dollar.
  - c) If you were a businessman importing clothes from the United States, calculate the amount of money you would have to pay for a \$200,000 worth of USA clothes before and after the change.
  - d) Explain how the situation of Pa'anga illustrated in graph 2 can lead to affect the local export and local import in Tonga's economy.
- 5)

**Table 1: International Transactions**

<b>Transactions</b>	<b>\$million</b>
Imports vehicles	200
Net invisibles	-104
Crops sold abroad	140
Income from investment abroad	50
Income from foreign investment	85
Foreign Aid	115

- a) Use the information in Table 1 to calculate the Current Account balance.
  - b) Multi-national Companies encourage foreign investment to support Tonga's economy. Explain how significant the above statement to support growth and development in Tonga's economy.
6. Define each of the four variables used in the Quantity Theory of Money equation.
- M:  
V:  
P:  
Q:

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7. Use **Irving Fisher's Equation** and your own knowledge to answer questions (a) to (c).

$$MV = PQ$$

- a. Assume an economy has nominal GDP of \$500 million and money supply of \$100 million, calculate **V** (Velocity of circulation) component of Fisher's Equation.
- b. State the component of Fisher's Equation will be adjusted to balance the equation if there is an increase in price level (**P**).
- c. Using the Quantity Theory of Money, explain how the changing in money supply may have affected the price level of output produced in an economy.

**Activity # 6**

1. Suppose there are only 2 goods bought by households, use the information in the table below to answer the question which follows.

<b>Goods</b>	<b>Quantity Bought (Base Year)</b>	<b>Price Per Unit (Base Year)</b>	<b>Price Per Unit (Current Year)</b>
Jeans	1000 pairs	\$25.00	\$30.00
Exercise Books	2000 books	\$1.50	\$2.00

- a. Calculate the Consumer Price Index (CPI) for the current year. **(Show all working).**
2. Use the data in the table given below and your own knowledge to answer the question.

<b>Commodities &amp; Quantity(Base year)</b>	<b>Price per Unit (Base Year)</b>	<b>Price Per Unit (Current Year)</b>
FMF Flour (5kg)	\$0.80	\$1.10
Soyabean Oil (5 litres)	\$0.90	\$1.20
Basmati Rice (10 kg)	\$1.90	\$2.40

- a. Calculate Consumer Price Index (CPI) for the current year. **(Show all working).**

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3. Causes of inflation can be classified into either 'Demand Pull' or 'Cost Push'.
- Use an example to describe Demand Pull inflation.
  - An increase in the price of oil is considered to be a cause of Cost Push inflation. Explain how an increase in the price of oil will cause inflation.
  - During times of inflation, different groups in the economy are affected in different ways. Some come out as 'winners', others as 'losers'.**

A fixed income earner is amongst the group of losers during times of inflation. Clearly describe how inflation affects a fixed income earner.

- Name **ONE** other group that is a loser during times of inflation.
- Explain how high inflation affects investment and growth.
- State what happens to the level of competitiveness of a country's exports during times of high domestic inflation.

4. 

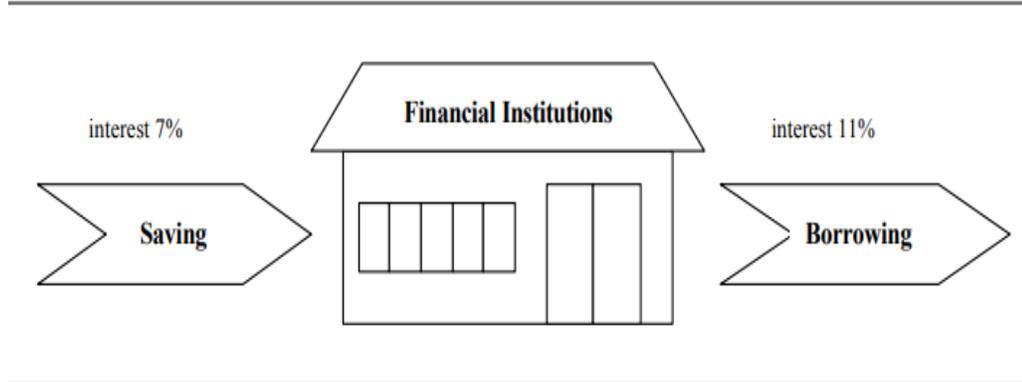
New Zealand's annual percentage increase in the CPI declined from 5.3% to 0.7% between the March quarter in 2011 and the March quarter in 2013. Source: RBNZ
--

Explain in detail why the change in the CPI identified in the stimulus above is an example of disinflation rather than an example of deflation. Refer to data from the resource material in your answer

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**Activity # 5**

1. Distinguish between tariffs and embargoes.
- 2.



- a. Name the Bank that controls the banking system in a country.
  - b. State two important functions of the bank referred to in (a) above.
  - c. Financial Institutions charge borrowers higher rates of interest than they offer to savers. Explain why financial institutions behave this way.
  - d. Define interest as used in the diagram.
3. Use the Equation of Exchange,  $MV = PT$ , to answer the questions that follow.
    - a. Define velocity of circulation.
    - b. What happens to the velocity of circulation in times of high economic growth?
    - c. If  $GDP = \$1000m$  and  $V = 5$ , calculate the value of  $M$ .
    - d. For each of the following cases, state how it is affected by an increase in money supply.
      - (i) Consumer demand
      - (ii) Prices

4.

YEAR	CPI
1999	900
2000	1000
2001	1120
2002	1290

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- Identify the base year
  - CPI is constructed using a “basket of consumer goods”. List two items from this basket.
  - Calculate the inflation rate between:
  - Use your answers in (c) to comment on the trend of the inflation rate from 2000 to 2002.
  - Explain the effect of inflation on fixed income earners.
  - Identify and explain one social effect of inflation.
  - Businesses can be both winners and losers in times of inflation. Comment on this statement.
5. State whether each economic event will have a **Cost Push** or **Demand Pull** effect on price level.

**Economic Events and their Effects on Price Level**

<b>Economic Events</b>	<b>Cost Push or Demand Pull</b>
Wage rates increase	Cost Push
Import prices fall	Demand Pull
Remittances from families abroad rise	Demand Pull
Direct tax decreases	Demand Pull
Oil prices rise sharply	Cost Push

6. (a) The table below lists the tools used by government to manage Monetary and Fiscal Policies. In the second column, write the correct policy (monetary or fiscal) for each management tool.

<b>Government Management Tools</b>	<b>Monetary or Fiscal Policy</b>
1. Increase government spending	Fiscal
2. Increase reserve requirement	Monetary
3. Levy higher goods and services tax	Fiscal
4. Control discount rate	Monetary
5. Encourage open market operations	Monetary

(5 marks)

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7. **The Paradise Island Money Supply: M1, M2, M3 (millions of dollars)**

<b>Money Component</b>	<b>Amount (million \$)</b>	<b>Money Supply (M1, M2, M3)</b>
<b>Travellers' Cheques/Checks</b>	<b>250</b>	<b>M1</b>
<b>Currency</b>	<b>3,000</b>	<b>M1</b>
<b>Small denomination time deposits</b>	<b>4,500</b>	<b>M2</b>
<b>Repurchase Agreements</b>	<b>3,000</b>	<b>M3</b>
<b>Demand Deposits</b>	<b>6500</b>	<b>M1</b>
<b>Other checkable deposits</b>	<b>12,000</b>	<b>M1</b>
<b>Treasury Bonds</b>	<b>32,000</b>	<b>M3</b>
<b>Large denomination time deposits</b>	<b>11,000</b>	<b>M3</b>
<b>Retail money market mutual funds</b>	<b>9,000</b>	<b>M2</b>

- a. Calculate the value of M1.
  - b. Calculate the value of M2.
  - c. Calculate the value of M3.
8. Using your knowledge of the Circular Flow of Income and with reference to appropriate flows of income, explain clearly the role of the following sectors.
- a) Financial Sector
  - b) Government Sector
9. Identify TWO reasons why Real GDP per Capita is NOT a perfect measure of economic growth
10. Identify the effect (increase/ decrease/ no effect) of the following on the level of money supply.
- a) The Australian Government cut back on their aid funding.
- 
- b) Fruit pickers program to Australia has increased this year by 15%.
- 
- c) Open Market Operation (OMO).

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11. Explain clearly the effect (increase/ decrease/ no effect) of the following on the level of money supply. You need to explain the reason why the effect occurs.
- a) A reduction in interest rate on lending.
  - b) Government reduce the age of those eligible for the elderly welfare payment from 75 to 70.

11. Read the passage below carefully and answer the questions that follow.

**Tonga - CPI February 2015 Media Release** The Consumer Price Index (CPI) for February 2015 (108.8) recorded a decrease from January 2015 (109.6). In comparison with the previous month, local index recorded a decrease of 1.1% and import index also decreased by 0.4%. For the previous two months, January 2015 recorded an increase of 2.1% and December 2014 decreased by 0.

- a. Calculate the inflation rate from Jan to Feb.
- b. The decrease in CPI from January to February 2015 means that prices of all goods and services were decreasing at the time. Do you agree or disagree? Give a reason for your answer.
- c. Give the formula for calculating CPI figures.
- d. Changes in average price level are mainly due to demand pull and cost push factors. a) Define demand pull inflation.
- e. Identify the effect (increase/decrease/no effect) of high inflation rate on the following.
  - a) Purchasing Power of Money \_\_\_\_\_
  - b) Level of future consumption \_\_\_\_\_
  - c) Level of investment \_\_\_\_\_

13. “During an inflationary period, economists claim that Borrowers are winners”. Explain clearly the reason behind this claim.

14.

<b>Situations</b>	<b>Effect on Average Price Level</b>	<b>Demand Pull or Cost Push</b>
Government operating a Budget Deficit		
The national event of the Coronation		

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15.

Country	Currency	Abbr	Bank Buys			Bank Sells
			Inward TT's	Cheques & T/C	Notes	TT
United States of America	Dollars	USD	0.5093	0.5218	0.5323	0.4873
Australia	Dollars	AUD	0.6574	0.6754	0.6964	0.6274
New Zealand	Dollars	NZD	0.6661	0.6951	0.7071	0.6311

- Define the term Exchange Rate
- What is the product that is being traded under the Foreign Exchange Market?
- A friend of yours gave you AUD \$520.00, how much Pa'anga would you have if using the exchange rate for April 2015. Show ALL necessary workings.

15. Identify ONE argument for and against Free Trade.

Argument For :

Argument Against:

16.

**TONGA'S BIGGEST BUDGET EVER, SO FAR**

The 'Akilisi Pohiva-led Government is proposing a budget of \$496 Million for the 2015/2016 financial year. That includes a \$5 million boost for government salaries along with new charges to be imposed on foreign exchange and a large increase in airport tax by \$100, from \$65 to \$165 for the next five years to raise funds for the 2019 Pacific Games. The new budget announced by the Minister of Finance, Hon. Dr 'Aisake Eke in the Tongan Legislative Assembly on May 2 is \$12.3 million more than the \$483.7 million budget he had announced while he was Finance Minister in the Lord Tu'ivakano-led government in 2014.

- Identify ONE objective of the 2015/2016 Budget as indicated in the passage above.
- Explain clearly the likely effect (achieve or hinder) of increasing government salaries on the aim of Price Stability.
- From the passage above, calculate the following showing ALL necessary workings.
  - Percentage increase in the Budget from 2014/2015 to 2015/2016.
  - Percentage increase in airport tax.
- Identify the effect (increase/ decrease/ no effect) of the following on a Budget Surplus.
  - Ministry of Police recruiting more to the police force.
  - Ministry of Revenue owing \$100,000 to Ministry of Infrastructure for repair works.
  - Decrease in number of business registration compared to last year.

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**Activity 6**

12.

<b>Production</b>	<b>Division of Labour</b>	<b>Specialisation</b>
<b>Diseconomies of scale</b>	<b>Productivity</b>	<b>Opportunity cost</b>

Choose from the list the appropriate economic concept that is associated with each of the life situations below. One term can be used more than once.

- Sione is the only son in the family so he has to drop out from school after passing TSC and work to pay for his younger sister's education.
- Sione is now a specialist woodcarver. In one day he can carve 10 small dolphins (about  $\frac{1}{2}$  a metre long).
- Sione's older sister has been running a hair salon and a coffee shop. This year she closed her hair salon and focus all her resources on the coffee shop.
- Sione's younger sister now graduated with a degree in management. She sets up a family business known as Sione's Design. She did the planning and manage the operation, the older sister did the designing and Sione with his woods, tools and skills did the carving. Together they invented a new product made from woods known as Salon Carving.
- e.