Tonga National Form Seven Certificate

ECONOMICS

2014

QUESTION and ANSWER BOOKLET

Time allowed: 3 hours

INSTRUCTIONS

Write Student Personal Identification Number (SPIN) on the top right corner of this page and on the fold-out flap on the last page.

Answer ALL QUESTIONS. Write your answers in the spaces provided in this booklet.

If you need more space for answers, ask the Supervisor for extra paper. Write your SPIN on all extra sheets used and clearly number the questions. Attach the extra sheets at the appropriate places in this booklet.

This paper is divided into FOUR SECTIONS. Answer ALL Sections.

<table>
<thead>
<tr>
<th>Marks</th>
<th>Times</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multiple Choice</td>
<td></td>
</tr>
<tr>
<td>Section A : Resource Allocation via the Market System</td>
<td>10 Marks</td>
</tr>
<tr>
<td>Section B : Resource Allocation via the Public Sector</td>
<td>42 Marks</td>
</tr>
<tr>
<td>Section C : Aggregate Economic Activity and Policy</td>
<td>18 Marks</td>
</tr>
<tr>
<td>TOTAL</td>
<td>100 MARKS</td>
</tr>
</tbody>
</table>

Check that this booklet contains pages 2-27 in the correct order and that none of these pages is blank. Pages 28 to 30 have been left blank deliberately.

YOU MUST HAND THIS BOOKLET TO THE SUPERVISOR AT THE END OF THE EXAMINATION.

TOTAL MARKS = 100
MULTIPLE CHOICE  

This Section contains 10 Multiple Choice questions that worth one mark each.

Write the LETTER of your choice in the box on the right of each question.

1. A shift in the demand curve for bread from D2 to D1 as shown in the diagram below could result from:
   
   A. decrease in income tax.  
   B. decrease in price of bread.  
   C. decrease in price of a substitute.  
   D. increase in supply of bread.

2. Why might an airline firm lower its ticket price during an off-peak season?
   
   A. Demand is elastic.  
   B. Demand is inelastic.  
   C. Supply is elastic.  
   D. Supply is inelastic.

3. A market structure which sells an unique product to the public is:
   
   A. oligopoly.  
   B. monopolistic competition.  
   C. perfect competition.  
   D. Monopoly.

4. What happen when the marginal costs are below average total costs?
   
   A. Average Total Costs are decreasing.  
   B. Average Fixed Costs are increasing.  
   C. Average Total Costs are increasing.  
   D. Average Fixed Costs are decreasing.

5. If a very small firm was to expand its scale of operations in the long run, it is likely that it would initially experience:
   
   A. increasing average total costs.  
   B. constant returns to scale.  
   C. economies of scale.  
   D. diseconomies of scale.
6. The difference between the average total cost and the average variable cost:
   A. is constant.
   B. is total fixed cost.
   C. gets narrower as output decreases.
   D. is the average fixed cost.

7. Which sector of the economy receives payments for using of factor inputs?
   A. Households.
   B. Firms.
   C. Government.
   D. Financial Institutions.

8. If an increase in income results in a decrease in the quantity demanded of a good, then the good is:
   A. a necessity.
   B. a normal good.
   C. an inferior good.
   D. a luxury.

9. What is the loss in total surplus resulting from a tax imposed?
   A. A deficit.
   B. Economic loss.
   C. Deadweight loss.
   D. Inefficiency.

10. A perfectly inelastic demand curve will be:
    A. vertical, because buyers purchase the same amount whether the price rises or falls.
    B. negatively sloped, because buyers decrease their purchases when the price rises.
    C. positively sloped, because buyers respond by increasing their purchases when price rises.
    D. horizontal, because buyers increase their purchases by huge amounts with slight changes in price.
QUESTION ONE : PRODUCTION POSSIBILITY CURVE MODEL (7 MARKS)

1. Explain why Production Possibility Curve is also called ‘transformation curve’? (1 mark)

______________________________________________________________________________
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2. Explain how a Production Possibility Curve illustrates the Concept of Scarcity. (1 mark)

______________________________________________________________________________
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3. Draw a production possibility curve for Agricultural goods (Y-axis) and Manufacturing goods (X-axis), to illustrate the following situations in an economy:

a. Firms move out of short-run periods and operate at long-run. (1 mark)

______________________________________________________________________________

b. Key non-renewable resources are running out (exhausted). (1 mark)

______________________________________________________________________________

c. The government subsidises fertilisers for the farmers. (1 mark)

______________________________________________________________________________
4. a. In the figure below, graphically analyse the best point for investment purposes. (1 mark)

b. With reference to the model in 4.a. above, what is the opportunity cost of future growth? (1 mark)
QUESTION TWO: COSTS AND REVENUES (5 MARKS)

Firm A

<table>
<thead>
<tr>
<th>Output</th>
<th>Total Cost</th>
<th>Fixed Cost</th>
<th>Variable Cost</th>
<th>Marginal Cost</th>
<th>Average Cost</th>
<th>Total Revenue</th>
<th>Average and Marginal Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>25</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td></td>
<td>10</td>
<td></td>
<td>(b)</td>
<td></td>
<td>8</td>
<td>(e)</td>
</tr>
<tr>
<td>2</td>
<td>42</td>
<td></td>
<td></td>
<td>(a)</td>
<td></td>
<td>8</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td></td>
<td>21</td>
<td>(a)</td>
<td>24</td>
<td>(d)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td></td>
<td>25</td>
<td></td>
<td></td>
<td></td>
<td>8</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>(c)</td>
<td>33</td>
<td></td>
<td></td>
<td></td>
<td>8</td>
<td></td>
</tr>
</tbody>
</table>

1. Calculate the missing values which are represented by the letters and write your answers in the space provided in the table above (3 marks)

2. According to the table above, **Firm A** is a price taker. Use marginal analysis to explain why Firm A is a price taker and not a price maker. (2 mark)
QUESTION THREE: DEMAND (10 MARKS)

1. Below is a table showing Alisi’s, Simote’s, and Kalo’s demand schedules for ‘squash’ (one of Tonga’s main exports).

<table>
<thead>
<tr>
<th>Price (dollars per kg)</th>
<th>Alisi</th>
<th>Simote</th>
<th>Kalo</th>
<th>Market Demand</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0.50</td>
<td>10</td>
<td>4</td>
<td>10</td>
<td>___</td>
</tr>
<tr>
<td>0.75</td>
<td>9</td>
<td>2</td>
<td>7</td>
<td>___</td>
</tr>
<tr>
<td>1.00</td>
<td>8</td>
<td>0</td>
<td>4</td>
<td>___</td>
</tr>
<tr>
<td>1.25</td>
<td>7</td>
<td>0</td>
<td>1</td>
<td>___</td>
</tr>
</tbody>
</table>

a. Assume that Alisi, Simote, and Kalo comprise the entire market. Complete the table by calculating the market demand. Write your answer in the spaces provided under the column ‘Market Demand’. (1 mark)

b. On a single diagram, draw the individual demand curves for Alisi, Simote and Kalo, as well as the market demand curve. (2 marks)

2. The statement given below is FALSE. Rewrite the statement to correct any mistake made.

The larger the fraction of a consumer’s income spent on a good, the more inelastic the demand for the good. (1 mark)
3. Use the Law of diminishing marginal utility to explain why a demand curve slopes downward?  

4. Suppose the ‘Tonga Weekly News’ estimates that if it raises the price of its newspaper from $1.00 to $1.50 then the number of buyers will fall from 50,000 to 40,000.

a. (i) What is the price elasticity of demand for the Tonga Weekly Newspaper when elasticity is calculated using the midpoint method?  

b. If the Tonga Weekly New’s only concern is to maximize total revenue, should it raise the price of its newspaper from $1.00 to $1.50 and Why or why not?
3. Distinguish between movement along a demand curve and shifts of the demand curve. 

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(1 mark)

QUESTION FOUR : SUPPLY (5 MARKS)

1. Economic costs equal **explicit costs** + **implicit costs.** Accounting costs include all explicit costs plus some of the implicit costs.

a. What is the major difference between accounting and economic costs? 

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(1 mark)

b. Identify one example of implicit costs that is included in the Accounting costs. 

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(1 mark)

c. Costs of raw materials and electricity expenses are elements of the Accounting costs. Which of the two expenses is direct cost and which is indirect cost and why? 

**Direct Cost :**

______________________________________________________________________________

**Reason :**

______________________________________________________________________________

(2 marks)

**Indirect Cost :**

______________________________________________________________________________

**Reason :**

______________________________________________________________________________
2. Which of the given pair of goods (Raw Materials and Electricity) would you expect to have the more elastic supply and Why? (1 mark)

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QUESTION FIVE : MARKET SITUATION (6 MARKS)

1. The graphs below illustrate the equilibrium conditions and how marginal revenues explain the pricing decisions under a perfectly competitive firm and a monopoly.

![Graph A](attachment:graph_a.png)  ![Graph B](attachment:graph_b.png)

a. Which of the graphs illustrates the situation of a perfectly competitive market and give one justification of your answer. (1 mark)

Graph _______________

Justification : ______________________________________________________

b. On Graph B,

i. locate and label the allocative efficiency output as Q1 (1 mark)

ii. shade the area of deadweight loss at the private output level. (1 mark)

iii. use diagonal lines to accurately illustrate the area of supernormal profit being earned by the monopolist at the monopoly equilibrium. (1 mark)
c. Using marginal analysis,

i. comment on the equilibrium conditions for a Perfect Competition and an Imperfect Competition

_____________________________________________________________________
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ii. compare the pricing decisions of a monopolist and a perfectly competitive firm.

(1 mark)
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QUESTION SIX : LABOUR MARKET (4 MARKS)

1. Supply

   Demand

   a. Mark and label the followings: (2 marks)
      
      i. Equilibrium wage rate (label We)
      
         ii. Minimum wage rate (label as Wm)
      
         iii. number of people employed at wage rate, We,(labeled Qe)
      
         iv. Result of wage rate, Wm, (labeled Qm)
b. Explain why Demand for Labour is a ‘Derived Demand’ (1 mark)
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c. Supply Curve for labour has an unusual shape of a backward bending curve as shown by the graph on page 11. Before the backward bending shape, the supply curve is in a perfectly inelastic shape. Explain the reason for the perfectly inelastic shape of the supply curve for labour. (1 mark)
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QUESTION SEVEN: INTERNATIONAL MARKET (5 MARKS)

1. Graphically analyse the following questions:

Market for Country A

<table>
<thead>
<tr>
<th>Price ($)</th>
<th>Domestic supply</th>
<th>World price</th>
<th>Domestic demand</th>
</tr>
</thead>
<tbody>
<tr>
<td>8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>A</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>5</td>
<td>B</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>C</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>F</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>D</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. What is the equilibrium price and quantity for the market illustrated by the graph above if Country A is a closed economy? (1 mark)

i. equilibrium price =

ii. equilibrium quantity =

P.12
3
b. If Country A is allowed to trade with other countries:

i. Will it import or export its commodity and why? (1 mark)

ii. What will be the quantity imported or exported? (1 mark)

c. Comment on the consumer surplus when Country A is a closed economy and when it becomes an open economy. (1 mark)

d. Comment on the gains from trade with reference to consumers and producers, if Country A involves in free trade? (1 marks)
SECTION B : RESOURCE ALLOCATION VIA THE PUBLIC SECTOR  18 MARKS

QUESTION ONE : EXTERNALITIES  (6 MARKS)

1. Define the term **Mixed Goods** with clear local example.  

______________________________________________________________________________  

______________________________________________________________________________  

______________________________________________________________________________  

______________________________________________________________________________  

(1 mark)

2. For each of the following examples:
   i. identify whether it is a positive or negative externality.
   ii. justify your answer.
   a. All the ‘heilala’ trees in front of Silivia’s compound are full blooming.  

   i. Type of externality -  ______________________________________________________  
   ii. Justification -  

   ___________________________________________________________________________  
   ___________________________________________________________________________  
   ___________________________________________________________________________  

   (1 mark)

   b. Your brother likes to smoke ten cigarettes a day in your backyard.  

   i. Type of externality -  ______________________________________________________  
   ii. Justification -  

   ___________________________________________________________________________  
   ___________________________________________________________________________  
   ___________________________________________________________________________  

   (1 mark)

3. Use the cost and benefit diagram below to illustrate a market that is experiencing a negative externality. Label the curves clearly.  

(1 mark)

[Diagram showing supply and demand curves with labels SMC, SMB, and output on the axes.]
a. From the society’s point of view, label on the graph on page 14 the optimum amount as ‘OA’. (1 mark)

b. Explain how the government could help to eliminate the inefficiency illustrated in (a) above. (1 mark)

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QUESTION TWO : PUBLIC GOODS AND NATURAL MONOPOLIES  (8 MARKS)

1. Public goods possess the possibility of the free-rider problem.

Explain how ‘free-rider problem affects the private markets from supplying public goods. (1 mark)

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2. Major Categories of goods are often grouped according to RIVAL and EXCLUDABLE. Explain what the following statements mean.

a. Goods are excludable. (1 mark)

__________________________________________________________________________
__________________________________________________________________________
__________________________________________________________________________

b. Goods are rival. (1 mark)

__________________________________________________________________________
__________________________________________________________________________
__________________________________________________________________________
3. Define ‘natural monopolies’ in terms of rival and excludable. Identify a clear example from your own local environment. (1 mark)

______________________________________________________________________________
______________________________________________________________________________
______________________________________________________________________________

4. Would you consider wireless internet a private good, a natural monopoly, a public good, or a common good? Justify your answer. (1 mark)

Justification:
______________________________________________________________________________
______________________________________________________________________________
______________________________________________________________________________

5. Use the given scenario to answer the questions that follow.

Suppose that the people of Ha’apai are debating whether to build a new bridge from Faleloa to Faakakai. The Ha’apai Development Committee survey finds that, on average, each of the 10,000 residents values the new bridge at a value of T$1000 and the bridge costs T$9.8 million to construct.

a. Assuming that the survey was accurate, is building of the new bridge efficient? (1 mark)
______________________________________________________________________________
______________________________________________________________________________
______________________________________________________________________________

b. Under what condition would a private firm build the bridge as a private good? (1 mark)
______________________________________________________________________________
______________________________________________________________________________
______________________________________________________________________________

______________________________________________________________________________

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a. Assuming that the survey was accurate, is building of the new bridge efficient? (1 mark)
______________________________________________________________________________
______________________________________________________________________________
______________________________________________________________________________

b. Under what condition would a private firm build the bridge as a private good? (1 mark)
______________________________________________________________________________
______________________________________________________________________________
______________________________________________________________________________

______________________________________________________________________________

c. Should the people of Ha’apai build the bridge? How much should it charge its residents to pay for the construction of the bridge? (1 mark)
______________________________________________________________________________
______________________________________________________________________________
______________________________________________________________________________
QUESTION THREE: EQUITY AND EFFICIENCY (4 MARKS)

1. Clearly distinguish between equity and efficiency. (1 mark)

___________________________________________________________________________
___________________________________________________________________________
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2. Apart from using Tax System (Progressive), describe TWO other methods of redistribution of income that the government might use in an attempt to achieve equity. (1 mark)

a. _________________________________________________________________________
_________________________________________________________________________

b. _________________________________________________________________________
_________________________________________________________________________

3. Study the Lorenz Curves Diagram below to help you answer the following questions.

![Lorenz Curves Diagram]

a. On the diagram above, draw and label the followings: (1 mark)
   a. Line of Complete equality.
   b. Market income.
   c. Disposable income

b. Use the Lorenz Curve to demonstrate the inequality of wealth and income distribution. (1 mark)

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QUESTION ONE: DOMESTIC AND EXTERNAL ACTIVITY (10 MARKS)

1. Study the Circular Flow Model below and answer the following questions.

a. Give the letter of the flow in the diagram that best represents the following: (2 marks)
   i. Import Payments: _____________
   ii. Gross Capital Formation: _____________
   iii. Transfer Payments: _____________
   iv. Final Consumption by government: _____________
b. The table below contains statistics for a hypothetical economy. Use the statistics to answer the following questions.

### GDP – NATIONAL ACCOUNTS

<table>
<thead>
<tr>
<th></th>
<th>$Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Final Consumption Expenditure:</td>
<td></td>
</tr>
<tr>
<td>- Private</td>
<td>15,200</td>
</tr>
<tr>
<td>- Government</td>
<td>4,600</td>
</tr>
<tr>
<td>Compensation of Employees</td>
<td>18,600</td>
</tr>
<tr>
<td>Increase in stocks</td>
<td>600</td>
</tr>
<tr>
<td>Operating Surplus</td>
<td>7,500</td>
</tr>
<tr>
<td>Gross Fixed Capital Formation</td>
<td>7,200</td>
</tr>
<tr>
<td>Net Exports</td>
<td>80</td>
</tr>
</tbody>
</table>

i. In order to calculate GDP using the statistics in the table above, what method should be used? (1 mark)

ii. Using the statistics in the table above, calculate the GDP. (2 marks)

iii. Distinguish between ‘Operating Surplus’ and ‘Compensation of Employees’. (1 mark)
2. Use the nominal GDP given below (for a hypothetical economy) to complete the followings::

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nominal GDP($m)</td>
<td>80,000</td>
<td>126,000</td>
</tr>
<tr>
<td>Consumer Price Index</td>
<td>1,000</td>
<td>1,111</td>
</tr>
<tr>
<td>Real GDP ($m)</td>
<td>(a)</td>
<td>(b)</td>
</tr>
</tbody>
</table>

a. Calculate the values of (a) and (b) and complete the table above. (1 mark)

b. Calculate the percentage change in Real GDP from 2010 to 2011. (Round off your answer to whole numbers) (1 mark)

3. The diagram below shows a change in foreign exchange market equilibrium for the Tongan pa’anga (T$) which is illustrated by a shift from D-1(T$) to D-2(T$).

a. Explain what has caused the change in the foreign exchange market equilibrium for the Tongan pa’anga (T$). (1 mark)

b. Clearly explain how Tongan exporters will be affected by the change in the exchange rate identified in (a) above. (1 mark)
QUESTION TWO : MONETARY AND FISCAL POLICY (10 MARKS)

1. Compulsory Reserve Ratio is a monetary policy which is designed to control the banks’ ability to expand credit and money supply. Define the term ‘Reserve Ratio’. (1 mark)

________________________________________________________________________
________________________________________________________________________
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2. Study the balance sheet below and answer the following questions.

<table>
<thead>
<tr>
<th>Assets $m</th>
<th>Liabilities $m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserve Assets</td>
<td>Demands Deposits 600</td>
</tr>
<tr>
<td>Overseas Assets 200</td>
<td>Term Deposits 400</td>
</tr>
<tr>
<td>Other Assets 100</td>
<td>300</td>
</tr>
<tr>
<td>Loans 100</td>
<td>700</td>
</tr>
<tr>
<td>1000</td>
<td>1000</td>
</tr>
</tbody>
</table>

a. If the Tongaland Financial Banks agree to hold reserves at 20% of deposits, how much more could they lend out immediately and what is the economic term for this process? (1 mark)

________________________________________________________________________
________________________________________________________________________
________________________________________________________________________
________________________________________________________________________

b. What would the ultimate effect of the above lending be on total deposits and total money supply? (1 mark)

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________________________________________________________________________
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________________________________________________________________________
3. Study the trade cycle or business cycle below and answer the following questions.

**PHASES OF THE BUSINESS CYCLE**

<table>
<thead>
<tr>
<th>Economic Activity</th>
<th>GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Years</td>
<td></td>
</tr>
<tr>
<td>C</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td></td>
</tr>
<tr>
<td>D</td>
<td></td>
</tr>
<tr>
<td>A</td>
<td></td>
</tr>
</tbody>
</table>

a. Name the stages of the business cycle represented by the letters in the graph above. (2 marks)

A : ______________________________

B : ______________________________

C : ______________________________

D : ______________________________

b. At which stage is the Reserve Bank likely to implement a **tight** monetary policy? Justify your answer. (1 mark)

_____________________________________________________________________

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4. Tax is a major component of the Government Budget. Is tax an **injection** or a **withdrawal**? Justify your answer. (1 mark)

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5. Net Expenditure in the budget includes all spending on collective goods and transfer spending. Collective goods and services may involve current expenditure and capital expenditure.

With examples, clearly explain what each type of expenditure is referred to in a budget. 

(1 mark)

________________________________________________________________________
________________________________________________________________________
________________________________________________________________________
________________________________________________________________________

6. Level of tax rates is a fiscal policy that helps to control the activities in the economy.
   
a. Will a cut on income tax results in an inflationary or a deflationary situation. 
   Graphically illustrates the impact on the AD (Aggregate Demand) and AS (Aggregate Supply) Model. 

(1 mark)

_____________________________________________________________________
_____________________________________________________________________
_____________________________________________________________________
_____________________________________________________________________

b. With regards to the impact illustrated in the AD/AS graph above, what effect does it have on the Real GDP and employment level? Show these effects on the AD/AS graph above. 

(1 mark)

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________________________________________________________________________
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P.23
QUESTION THREE : AGGREGATE DEMAND AND SUPPLY (10 MARKS)

1. \( Y \) or \( AD = C + I + G + (X-M) \)
   
a. \( C \) includes autonomous consumption and induced consumption. Distinguish between autonomous and induced consumption. (1 mark)

b. \( I \) includes intended investment and unintended investment. Distinguish between these two types of investment. (1 mark)
2. Match the graphs in Column A with the description that best suits it from Column B by writing the letter of the description in the space provided in each graph. (2 marks)

COLUMN A

a. _____

b. _____

c. _____

d. _____

COLUMN B

A. result of a contractionary fiscal policy.
B. import prices fall.
C. inflationary gap
D. productivity falls
E. recessionary gap
F. result of an expansionary fiscal policy
3. Use the two graphs below (graphs 1 and 2) to assist you in answering the following questions.

(a) Distinguish between graph 1 and graph 2 with regards to equilibrium level of employment and production. (2 marks)

________________________________________________________________________
________________________________________________________________________
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________________________________________________________________________

(b) Of the two situations illustrated by the graph above, which graph is more applicable to the South Pacific region? Justify your answer. (1 mark)

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c. On a Production Possibility Curve diagram, mark two separate dots to illustrate each situation under each of the two graphs (graphs 1 and 2) above. Assume that the two goods are $X$ (on x-axis) and $Y$ (on y-axis). Labels the dot for situation in graph 1 – $A$, and $B$ for situation in graph 2. (1 mark)

4. a. Carefully construct the AD/AS model to illustrate an increase in productivity through investment. (1 marks)

b. Briefly explain how the diagram above relates the a situation of stagflation. (1 mark).

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Tonga National Form Seven Certificate

ECONOMICS

2014

<table>
<thead>
<tr>
<th>SECTIONS</th>
<th>MARK</th>
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