

## ECONOMICS PAPER 1

8.30 am – 9.30 am (1 hour)

### INSTRUCTIONS

1. Read carefully the instructions on the Answer Sheet. After the announcement of the start of the examination, you should first stick a barcode label and insert the information required in the spaces provided. No extra time will be given for sticking on the barcode label after the 'Time is up' announcement.
2. When told to open this book, you should check that all the questions are there. Look for the words '**END OF PAPER**' after the last question.
3. All questions carry equal marks.
4. **ANSWER ALL QUESTIONS.** You are advised to use an HB pencil to mark all the answers on the Answer Sheet, so that wrong marks can be completely erased with a clean rubber. You must mark the answers clearly; otherwise you will lose marks if the answers cannot be captured.
5. You should mark only **ONE** answer for each question. If you mark more than one answer, you will receive **NO MARKS** for that question.
6. No marks will be deducted for wrong answers.

Not to be taken away before the  
end of the examination session

There are 40 questions in this paper. Choose the **BEST** answer for each question.

1.

The Hong Kong government proposes to build new towns with residential flats and shopping malls in the North District. However, there are concerns about the ratio of public housing to private housing. Some people are also worried about the size of shopping malls, which may mainly serve mainland tourists.

The above case is related to the \_\_\_\_\_ question(s) in Economics.

- A. “for whom to produce”
  - B. “what to produce” and “how to produce”
  - C. “what to produce” and “for whom to produce”
  - D. “how to produce” and “for whom to produce”
2. Jeremy is going to watch a tennis match in which Li Na (李娜), a Grand Slam (大滿貫) winner, will play. Which of the following will increase the cost to Jeremy of watching the tennis match?
- A. He is 30 minutes late for the match due to traffic congestion.
  - B. His view is blocked by the spectators in front of him.
  - C. Due to a rainstorm, the match is extended by an hour.
  - D. Li Na is injured and does not show up for the match.

3. The following table shows the cost-output relationship of a firm.

Outputs (units)	0	1	2	3	4	5
Total cost (\$)	10	28	42	52	60	72

Based on the above table, we can conclude that

- A. the firm enjoys the benefits of economies of scale.
- B. the firm’s optimal scale of production is 5 units of outputs.
- C. the average variable cost is increasing.
- D. the total fixed cost is \$10.

4.

Machines (units)	Labour (units)	Average Product (units)
2	3	30
2	4	40
2	5	50
2	6	55

The above table shows a \_\_\_\_\_ situation in which \_\_\_\_\_.

- A. short run ... the law of diminishing returns does not apply
- B. short run ... the law of diminishing returns applies
- C. long run ... economies of scale exists
- D. long run ... diseconomies of scale exists

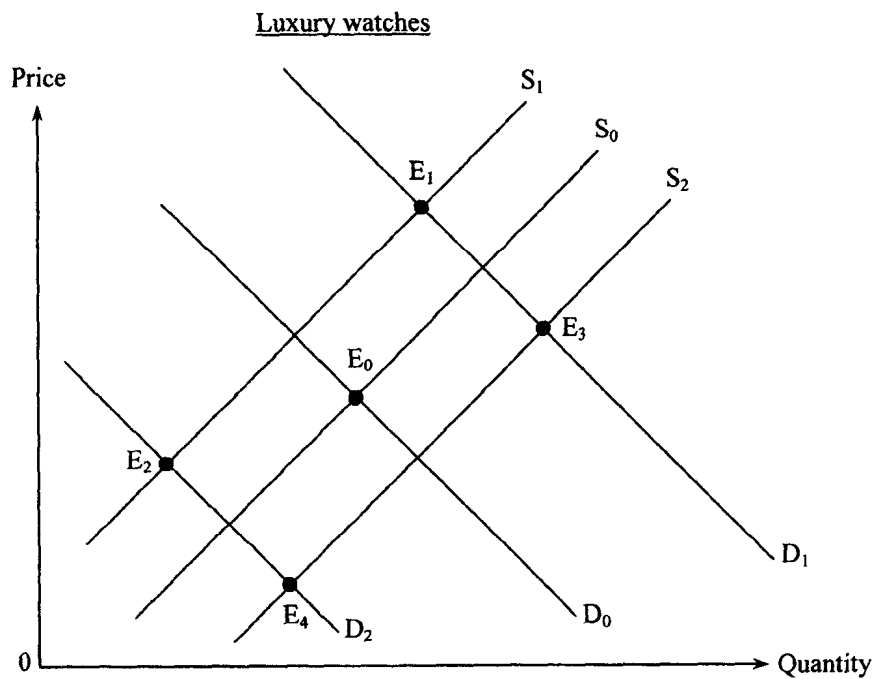
5. In order to increase the number of nurses for expanding medical services, the government has allocated more resources to expand the nursing programme in universities. In this case, private hospitals will
- A. enjoy internal economies of scale.
  - B. suffer internal diseconomies of scale.
  - C. enjoy external economies of scale.
  - D. suffer external diseconomies of scale.
6. The television broadcast of European football matches is
- A. a public good if citizens can enjoy the broadcast of matches in public areas like restaurants and Karaoke lounges.
  - B. a private good if a local television broadcasting company has purchased the exclusive right to broadcast in Hong Kong.
  - C. a free good because there is no cost in serving an additional viewer.
  - D. a producer good if the broadcast is used to teach the children in a football training school.
7. Teachers in secondary schools are usually paid by time rate because
- A. this can improve their work incentive.
  - B. they prefer a stable income.
  - C. most teachers are hardworking.
  - D. it is costly to measure their outputs.
8. A firm can ensure a steady supply of raw materials by engaging in \_\_\_\_\_ while it can increase its market share by engaging in \_\_\_\_\_.
- A. backward integration ... horizontal integration
  - B. backward integration ... lateral integration
  - C. forward integration ... horizontal integration
  - D. forward integration ... lateral integration
9. If a partnership is turned into a private limited company,
- (1) the company will become an independent legal entity.
  - (2) the company will be at a higher risk of being taken over.
  - (3) the company will pay a higher profits tax rate.
  - (4) the number of owners will increase.
- A. (1) and (3) only
  - B. (1) and (4) only
  - C. (2) and (3) only
  - D. (2) and (4) only

10. Which of the following is assumed to be constant when the market demand curve of a good is derived?

- (1) the income of the consumers
- (2) the price of the good
- (3) prices of related goods
- (4) preference of the consumers

- A. (1) and (3) only
- B. (2) and (3) only
- C. (1), (2) and (4) only
- D. (1), (3) and (4) only

11. Refer to the following demand-supply diagram showing the market of luxury watches in Hong Kong. The initial equilibrium point is  $E_0$ .



Suppose the rental of shopping premises in Hong Kong rises sharply and the economy in the mainland experiences a recession. The new equilibrium point will be \_\_\_\_\_.

- A.  $E_1$
- B.  $E_2$
- C.  $E_3$
- D.  $E_4$

12. A drop in the price for good X will lead to a drop in the price of good Y if

- (1) good X and good Y are substitutes.
- (2) good X and good Y are complements.
- (3) good X and good Y are in competitive supply.
- (4) good X and good Y are in joint supply.

- A. (1) and (3) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (2) and (4) only

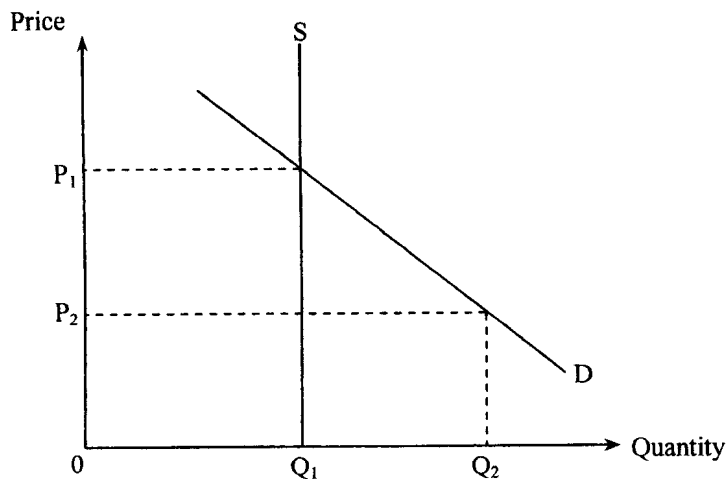
13. The following table shows the demand and supply schedule of good X.

Price (\$)	2	3	4	5	6	7	8
Quantity demanded (units)	90	80	70	60	50	40	30
Quantity supplied (units)	30	40	50	60	70	80	90

Suppose the government imposes a \$2 per-unit sales tax on each unit of good X sold. The total sales revenue net of tax is \_\_\_\_\_.

- A. \$180
- B. \$200
- C. \$280
- D. \$300

14. Refer to the following demand-supply diagram:

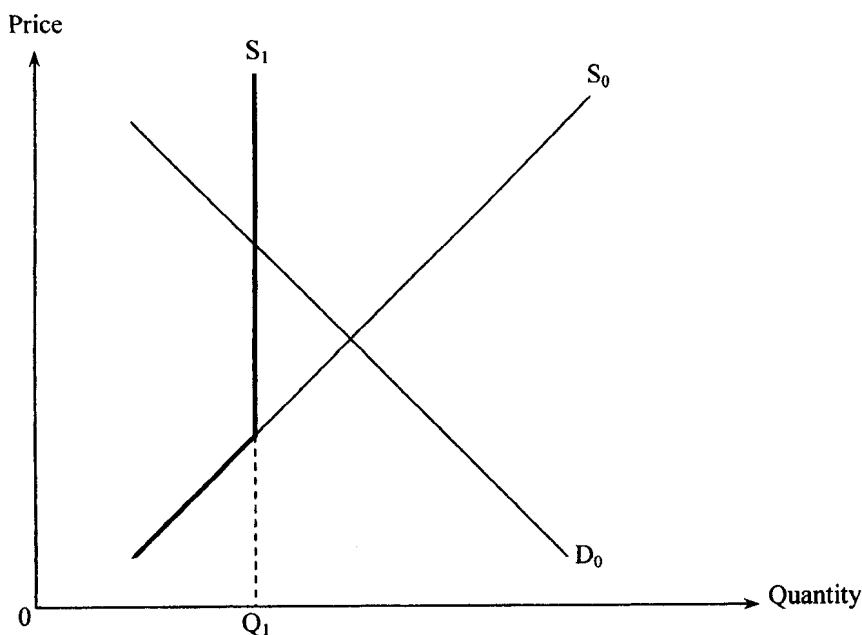


If the government raises the price floor from  $P_2$  to  $P_1$ , the total revenue received by the sellers

- A. will rise.
- B. will fall.
- C. will remain unchanged.
- D. may rise or fall, depending on the price elasticity of demand.

15. Suppose the government introduces an effective rent control which sets a maximum rental per square feet the landlords can charge to any tenants. Which of the following statements is correct?
- (1) There will be a shortage of rental units.
  - (2) The landlords will have less incentive to rent out their flats.
  - (3) The landlords will spend less on maintenance of the rental flats.
- A. (1) and (2) only
  - B. (1) and (3) only
  - C. (2) and (3) only
  - D. (1), (2) and (3)
16. Which of the following is **INCONSISTENT** with the law of demand?
- A. When a higher per-unit import tariff is imposed, the quality of garment imports worsens.
  - B. When a government reduces the unemployment benefit, the number of unemployed people drops.
  - C. When political unrest in a country causes riots in its major cities, the number of tourists visiting the country drops.
  - D. When people expect the price of the shares of a listed company to rise, the price of those shares rises.
17. The market structure of the electric power industry in Hong Kong is
- A. an oligopoly because there are two dominating companies in the market.
  - B. an oligopoly because the pricing strategies of the companies are interdependent.
  - C. a monopoly because the companies can increase the price without losing customers.
  - D. a monopoly because there is only one electric company providing electricity in any district.
18. Suppose the market equilibrium output level is greater than the efficient output level. It implies that
- A. total social surplus will increase if output is reduced towards the efficient output level.
  - B. at the equilibrium output level, marginal benefit is greater than marginal cost.
  - C. the sum of consumer surplus and producer surplus is maximized as the market output level satisfies the equilibrium condition.
  - D. government intervention is necessary to reduce output as there is over-production.

19. Refer to the following demand-supply diagram of a good with the government setting a quota at  $Q_1$ .



Which of the following will be the result of a reduction in quota on the good?

- (1) The total expenditure on the good may increase or decrease.
- (2) The consumer surplus will decrease.
- (3) The total social surplus may increase or decrease.

- A. (1) only
- B. (1) and (2) only
- C. (2) and (3) only
- D. (1), (2) and (3)

20. A beekeeper keeps the bees for their honey. The bee-keeping benefits the farmers in the orchard nearby because the bees help pollinate the fruits in the orchard. Which of the following statements about this case is correct?

- A. There will be a divergence between private and social benefits and the honey is over-produced.
- B. The beekeeper should be subsidized by the government to improve economic efficiency.
- C. If the value of honey is higher than the value of fruits, there is no need for the government to intervene to correct the externality.
- D. There will be no divergence between private and social benefits if the orchard nearby is owned by the beekeeper.

21. Which of the following items is **NOT** included in the calculation of Hong Kong's net factor income from abroad for the current year?
- A. the income received by a Japanese teacher who worked in a language school in Hong Kong for one year
  - B. rental income earned from real estate holdings in Canada owned by a Hong Kong resident
  - C. salary received by an Indian consultant who worked for the Hong Kong Airport Authority for three months
  - D. dividends earned from shares in Hong Kong held by a US resident
22. Consider the following Gross Domestic Product (GDP) data about a country.

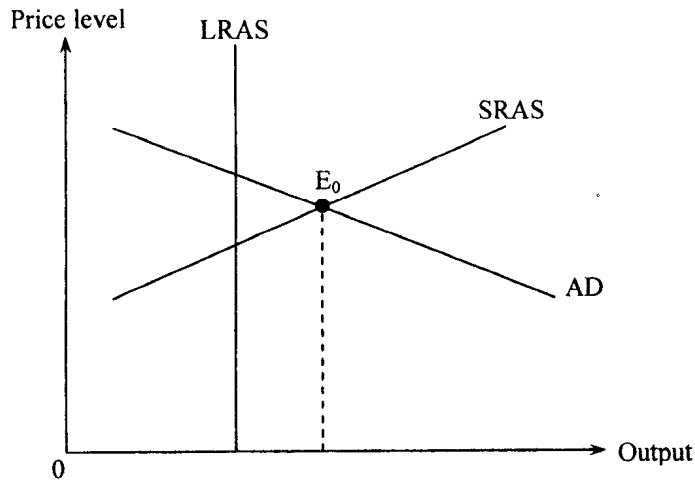
Components	\$ million
GDP at market price	200
Private consumption expenditure	120
Gross domestic fixed capital formation	40
Changes in inventories	10
Total exports of goods	80
Domestic exports of goods	70
Imports of goods	60
Exports of services	20
Imports of services	30
Net income from abroad	25
Depreciation	35
Indirect business tax	28
Subsidies	18

The government consumption expenditure for that year is \$ \_\_\_\_\_ million.

- A. 20
  - B. 30
  - C. 40
  - D. 50
23. The aggregate demand curve will shift to the right if
- A. there is a fall in the price level.
  - B. there is an improvement in technology.
  - C. the government reduces the import tariff.
  - D. the government reduces the salaries tax rate.



24. The diagram below shows the aggregate demand (AD) curve, the short run aggregate supply (SRAS) curve and the long run aggregate supply (LRAS) curve of an economy.



Suppose initially the economy operates at  $E_0$ . There is a/an \_\_\_\_\_ and \_\_\_\_\_ can help restore the long run equilibrium.

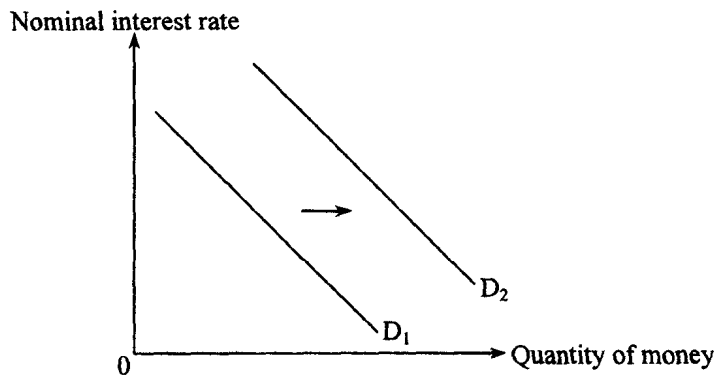
- A. inflationary (output) gap ... a rise in transfer payments to the poor
  - B. inflationary (output) gap ... a rise in the discount rate
  - C. deflationary (output) gap ... a rise in transfer payments to the poor
  - D. deflationary (output) gap ... a rise in the discount rate
25. Which of the following is included in the money supply M2?
- (1) legal tender held by licensed banks
  - (2) demand deposits with licensed banks
  - (3) time deposits with restricted licence banks
  - (4) negotiable certificates of deposit issued by licensed banks held by the non-bank public
- A. (2) and (3) only
  - B. (2) and (4) only
  - C. (1), (2) and (4) only
  - D. (1), (3) and (4) only

26. Initially, a banking system has an excess reserve of \$160 million and the public holds \$200 million cash. The balance sheet of the banking system is as follows:

Assets (\$million)		Liabilities (\$million)	
Reserves	400	Deposits	1 200
Loans	800		

Suppose \$100 million is withdrawn from the banking system and held as cash by the public. What will the money supply be if the banks lend out all excess reserves?

- A. \$1 500 million  
 B. \$1 700 million  
 C. \$1 800 million  
 D. \$2 300 million
27. Refer to the following diagram.

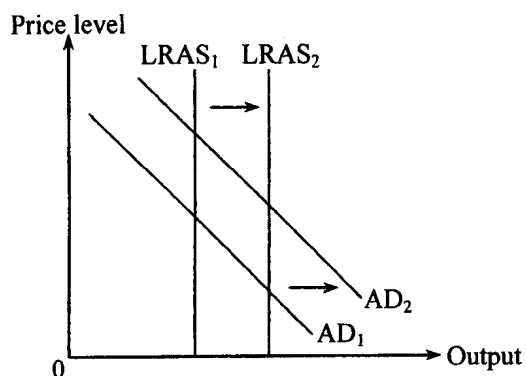


Which of the following will cause the money demand curve to shift from  $D_1$  to  $D_2$ ?

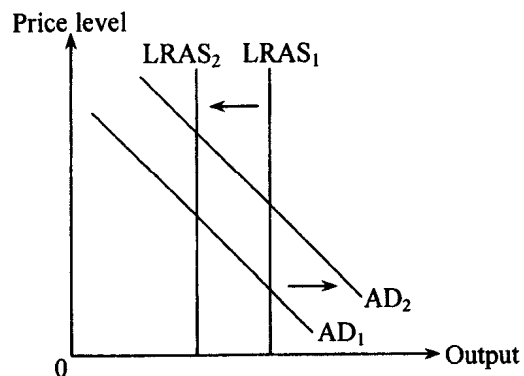
- A. a fall in the nominal interest rate  
 B. a rise in national income  
 C. more widespread use of electronic money  
 D. an open market purchase of bonds by the central bank
28. An expansionary monetary policy is adopted in China when
- (1) the Ministry of Finance (財政部) provides cash subsidies to agricultural workers.
  - (2) the People's Bank of China (中國人民銀行) reduces the required reserve ratio of all commercial banks.
  - (3) the Bank of China lowers its lending rate to small and medium-sized enterprises.
- A. (1) only  
 B. (2) only  
 C. (3) only  
 D. (1), (2) and (3)

29. Suppose the government greatly increases the tax allowance on continuing education. Which of the following can best explain the effect of the above change on the price and output levels?

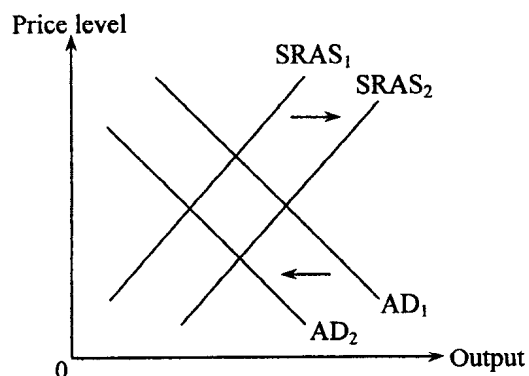
A.



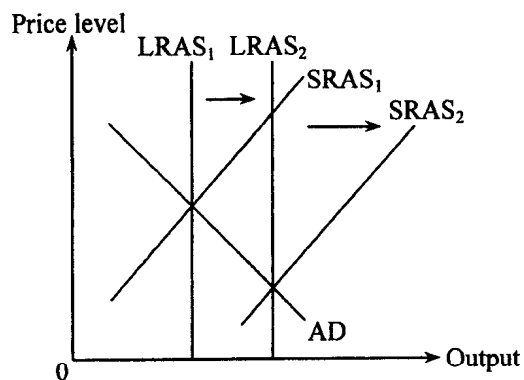
B.



C.



D.



30. If there is a decrease in the desire to consume, the net exports of an economy will \_\_\_\_\_ and the amount of money held for transaction purposes will \_\_\_\_\_.

- A. decrease ... decrease
- B. decrease ... remain constant
- C. increase ... increase
- D. increase ... decrease

31. Initially an economy operates at the full-employment equilibrium and the government expenditure equals its tax revenue. Which of the following will result in a coexistence of deflationary (output) gap and budget deficit?

- A. a reduction in taxes
- B. a reduction in money supply
- C. a reduction in government expenditure
- D. a reduction in desire to import

32. The real output of an economy grows at a lower rate than the money supply. According to the quantity theory of money, we can conclude that

- (1) the price level is increasing.
- (2) the unemployment rate is decreasing.
- (3) the velocity of circulation of money is decreasing.
- (4) the nominal output is increasing.

- A. (1) and (2) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (3) and (4) only

33. The following phenomena are observed in an economy:

- (1) The unemployment rate is increasing.
- (2) The inflation rate is no longer rising but falling instead.
- (3) The inventories of producers are accumulating.
- (4) The forecast of economic growth is revised downward.

The economy is in the \_\_\_\_\_ phase of a business cycle.

- A. recession
- B. trough
- C. recovery
- D. peak

34. Which of the following people will benefit from unanticipated inflation?

- A. A loan shark who lends out a sum of money at a floating interest rate
- B. A manager who receives a fixed salary with the period of a two-year contract
- C. A flat-owner who repays a fixed-rate mortgage loan
- D. A retired teacher who receives dividends from various listed companies

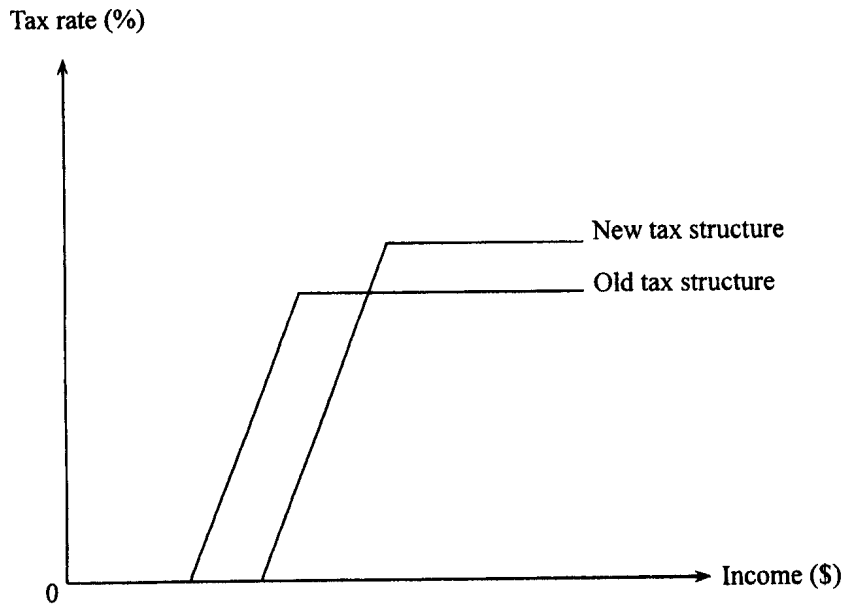
35.

In July 2009, the government introduced an environmental levy of 50 cents on each plastic shopping bag at the retail level, with the first phase covering chain or large supermarkets, convenience stores and personal health and beauty product stores. Small shops are exempted in the first phase. Customers can pay the levy, with the original amount of purchase of goods, by credit card, Easy Pay System (EPS) or cash.

The collection of the above environmental levy is **LEAST** in line with the \_\_\_\_\_ principle of taxation put forward by Adam Smith.

- A. equality
- B. economy
- C. convenience
- D. certainty

36. The following diagram shows the change in the salaries tax structure of an economy.



Compared to the old salaries tax structure, the new tax structure

- A. has a smaller personal allowance.
  - B. has a lower standard tax rate.
  - C. will narrow the income gap between the rich and the poor.
  - D. will widen the tax base.
37. A country's currency appreciates against its trading partners' currencies. If the country's demand for imports is \_\_\_\_\_, the appreciation of its currency will lead to \_\_\_\_\_ in the total import value (in terms of domestic currency).
- A. unitarily elastic ... a rise
  - B. inelastic ... a rise
  - C. elastic ... a fall
  - D. inelastic ... a fall

Answer Questions 38 and 39 by referring to the following information.

Before trade, the output of Thailand and Japan with all their resources evenly allocated between the production of rice and computers is shown below:

	Rice (units)	AND	Computers (units)
Thailand	15	AND	5
Japan	24	AND	12

38. Which of the following statements about the above case is correct?
- (1) Japan has a comparative advantage in producing computers.
  - (2) Japan has an absolute advantage in producing computers.
  - (3) With complete specialization in the two countries, the total output of both rice and computers will increase.
- A. (1) only  
B. (1) and (2) only  
C. (2) and (3) only  
D. (1), (2) and (3)
39. Suppose the terms of trade is 1 unit of computers = 2.4 units of rice and the computer-exporting country has to pay a transportation cost of 0.1 units of rice for each unit of export. To export 5 units of computers, the net gain of the country is \_\_\_\_\_ units of rice.
- A. 1.5  
B. 2  
C. 2.5  
D. 3
40. Which of the following statements about the linked exchange rate system of Hong Kong is correct?
- (1) Hong Kong dollar banknotes are fully backed by Renminbi and the US dollar.
  - (2) The Hong Kong Monetary Authority holds a considerable amount of foreign exchange reserves.
  - (3) All note-issuing banks can exchange for US dollars at the linked rate with the Hong Kong Monetary Authority.
  - (4) The exchange rate of the Hong Kong dollar to the US dollar in the foreign exchange market is fixed.
- A. (1) and (2) only  
B. (1) and (4) only  
C. (2) and (3) only  
D. (3) and (4) only

**END OF PAPER**

Sources of materials used in this paper will be acknowledged in the Examination Report and Question Papers published by the Hong Kong Examinations and Assessment Authority at a later stage.