

Section A (50 marks)

1. Peter borrowed a book from Mary and he promised to return the book with a bookmark to her a month later. Explain why the bookmark could be regarded as "interest" to both Peter and Mary. (4 marks)

To Peter, as a borrower of book for earlier consumption, ~~the book~~ bookmark is an interest as it is the cost for earlier availability of goods or resources (book).
To Mary, as a lender of book, she need to delay consumption, so bookmark is an interest as it's compensation for ~~deferring~~ deferring consumption.

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2. A Chinese car manufacturer acquired a Swedish car manufacturer in 2010. Explain which type of integration was involved in this case and state **THREE** possible motives for this type of integration. (5 marks)

This is a horizontal integration as Chinese car manufacturer combines with another firm producing same product (car).
Its motives are to enjoy economies of scale such as lower cost in financing, increase market share (which can in turn affect market supply and price if it's big enough) and turns competitors into business parts (so as to reduce duplication of facilities).

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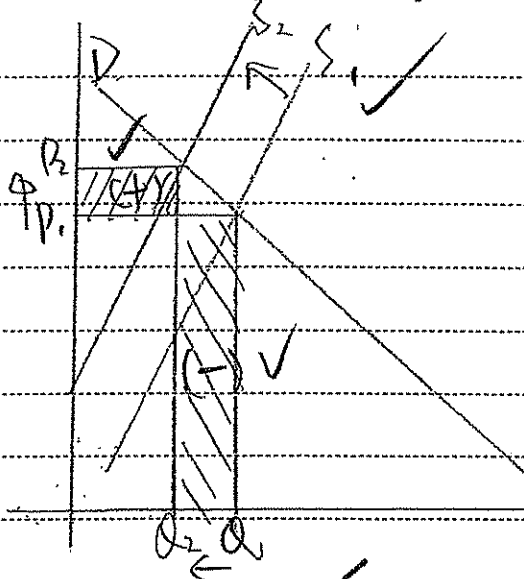
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3. The earthquake in Japan greatly damaged the production facilities of memory products like Secure Digital (SD) cards. As a result, the prices of these products rose. With the aid of a diagram, explain under what condition the total expenditure of Japanese consumers on the memory products would fall. (7 marks)



As the production facilities are damaged, the supply of memory products fall, hence price rise but quantity demanded fall. If the demand is elastic the percentage fall in quantity demanded is greater than the percentage rise in price. So a rise in total expenditure due to rise in price is smaller than a fall in total expenditure due to fall in quantity demanded. Hence the total expenditure of Japanese must fall.

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4. (a) What is "deadweight loss"?

(b)

A teacher said, "An effective price ceiling may increase the consumer surplus."
His student replied, "If this is the case, the price ceiling may enhance economic efficiency!"

(i) Do you agree with the teacher? Illustrate your answer in Figure 1. (3 marks)

(ii) Do you agree with the student? Explain your answer with the aid of Figure 2. (5 marks)

Figure 1

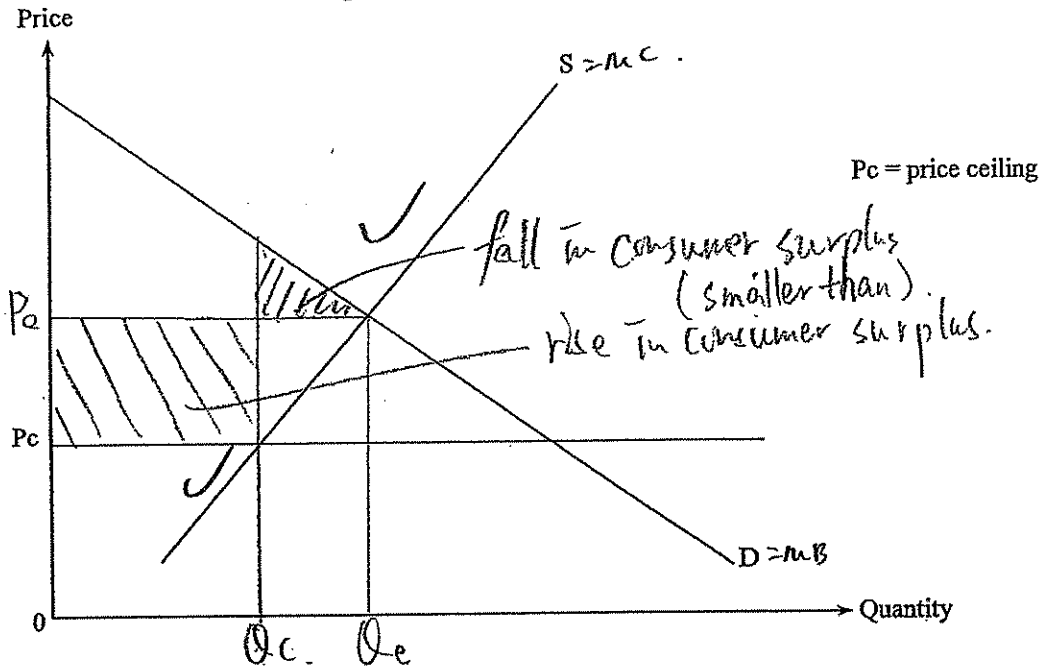
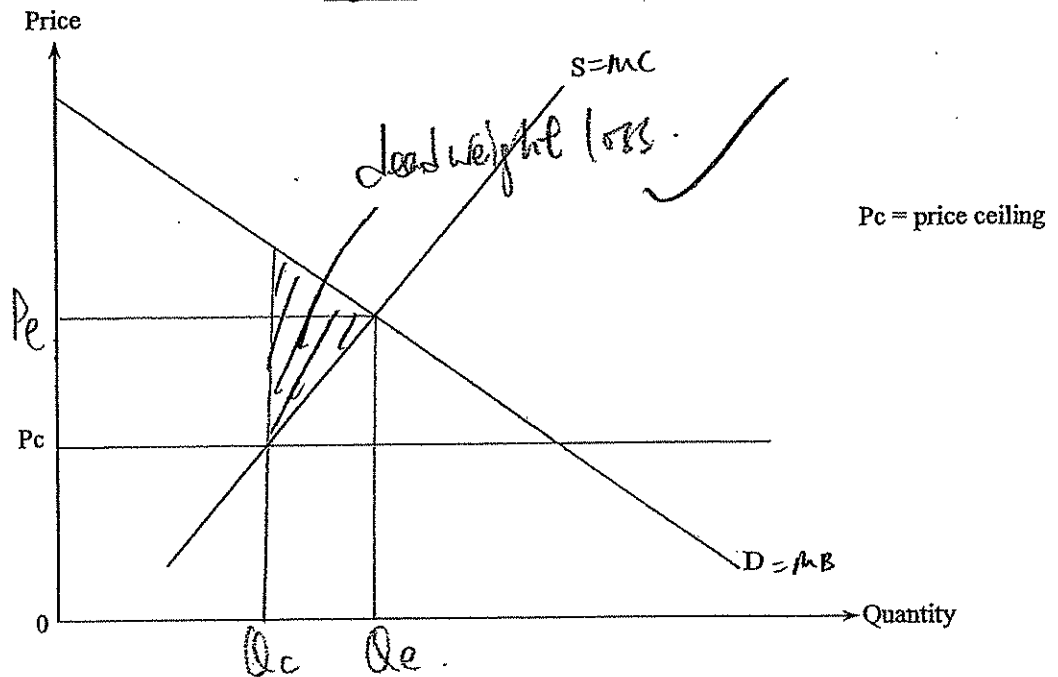


Figure 2



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a. Deadweight loss is the loss of total social surplus due to a deviation of production point from the efficient point, hence total social surplus is not maximized and result in inefficiency.

b. i. Agree, since fall in consumer surplus can be smaller ^{due to fall in quantity demanded} than the increase in consumer surplus due to the fall in price.

b. ii.

b. ii. Disagree. As after imposing an effective price ceiling, price is set below equilibrium so that quantity demanded is greater than quantity supplied.

At new quantity level (Q_c), marginal benefit ^{of consumer} is greater than marginal cost of producer, hence there is deadweight loss due to underproduction since Q_c is lower than the efficient level (Q_e) where $MB = MC$.

Since there is deadweight loss, inefficiency result even though consumer surplus may rise as total social surplus is not maximized.

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5. Mr. Richardson, a British civil engineer, has worked for a large Hong Kong construction company in the past few years. He is earning an annual income of HK\$800 000 and he remits part of his income to his family in Britain. Is Mr. Richardson's income counted in HK's gross domestic product (GDP)? (3 marks) Give your answer.

GDP is the total monetary value of final goods and services produced by all resident producing units in a country in a year. Since his earning of \$800,000 is his income by providing factor services (labour) to ~~the~~ ^{HK} resident producing units, it should be counted in HK's GDP in full.

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6. The following is a news report about Economy A.

Skilled construction workers are in great demand after the launch of the construction project of a new high-speed railway system. A government official has announced the introduction of a labour importation scheme to meet the need for skilled workers.

Suppose the imported workers do not replace any of the domestic workers. Explain how the unemployment rate will be affected by the scheme. (4 marks)

Unemployment rate = $\frac{\text{number of unemployed population}}{\text{labour force}}$

Since after the importation, imported workers doesn't cause any unemployment, so number of unemployed population remain unchanged while labour force increase. Hence, unemployment rate will decrease.

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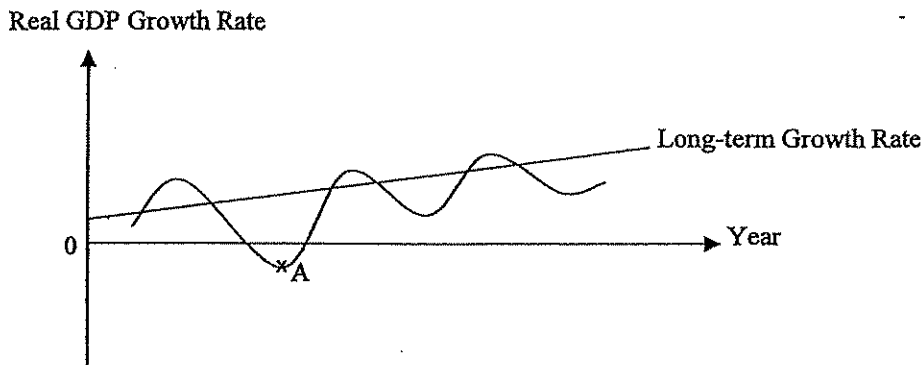
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7. Refer to the business cycle shown in Figure 3. Identify the phase which point A is in. Apart from the information about the real gross domestic product (GDP) growth rate in this phase, give **THREE** general economic phenomena which occur in this phase. (4 marks)

Figure 3



Point A refers to depression. ✓

the general economic phenomena are a fall in unemployment rate (nearly full unemployment), fall in aggregate demand, and a fall in price level (negative inflation rate).

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8. Demand deposits can be regarded as money. Explain which **TWO** functions of money they can perform. (4 marks)

Medium of exchange. People can exchange goods for demand deposit via cheque and exchange demand deposit for goods via cheque. Hence, demand deposits serve as a generally accepted medium for buying and selling.

Store of value. People can deposit cash into demand deposit ~~so as to store wealth~~ for future use and accumulate wealth as they need not buy goods when they sell goods with the use of demand deposits.

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9. Country A and Country B possess the same amount of resources. While Country A uses half in producing food and half in producing computers, Country B uses one-third of its resources in producing food and two-thirds in producing computers. Their total output in a year is shown below.

	Food (units)	Computers (units)
Country A	100	50
Country B	200	100

Explain whether Country B has

- (a) an absolute advantage; and
- (b) a comparative advantage

in producing food.

(6 marks)

9a. ~~With~~ When both country use all resources to produce one goods,

	Food (units)	Computer (units)
Country A	200	100
Country B	400 200	150

Hence, Country B has an absolute advantage in producing food as it can produce more unit of food with the same amount of resources (than Country A)

b. Opportunity cost of producing food in Country A = 0.5 computer
 Opportunity cost of producing food in Country B = 0.25 computer

As Country B has a comparative advantage in producing food as it ~~can~~ has lower opportunity cost of producing food than Country A.

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10. Suppose the US dollar depreciates against the Euro. Under the linked exchange rate system, how will the following items be affected?

- (a) The total number of Hong Kong tourists travelling to European countries
- (b) The prices (in Euro) of Hong Kong toys exported to Europe
- (c) The total expenditure (in Hong Kong dollar) of Hong Kong on imported European automobiles

(3 marks)

a. Decrease ^{price of Europe increase} as goods in Euro appreciate in term of HKD under linked exchange rate system of HKD to USD.

b. Fall as Euro appreciate against HKD under the linked exchange rate system of HKD to USD.

c. As price of European imported automobiles rise in term of HKD, less of it is bought. Hence, total expenditure may rise, fall or remain unchanged, depend on price elasticity of demand of import European automobiles.

END OF SECTION A

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Section B (54 marks)

11. The prices of textbooks for senior secondary education have increased sharply because textbook publishers have to publish new textbooks for the new curriculum.
- (a) The production of textbooks involves various experts, including authors, editors, graphic designers, etc. What economic principle is illustrated? Give **THREE** reasons to explain why this principle can raise labour productivity. (4 marks)
 - (b) Explain whether the knowledge in the textbooks is a public good. (3 marks)
 - (c) In Hong Kong, to which type of market structure do the publishers belong? State **TWO** features of this type of market structure. (3 marks)
 - (d) Under the School Textbook Assistance Scheme (STAS), needy students are granted subsidies to cover the costs of textbooks and miscellaneous school-related expenses. Explain how STAS can enhance equity in Hong Kong society. (4 marks)

Answers written in the margins will not be marked.

a. Complex division of labour. ✓
 Reasons are to ~~save~~ save time for training and educating workers, save time for moving around and adjust to different tasks, and save ~~resources~~ resources spent on capital goods.

b. Yes. The knowledge is non-excludable since it is ~~hard~~ hard to prevent non-payers from acquiring the knowledge. ✓
 Also, it is ~~the~~ non-rivalry in consumption as one's acquisition of knowledge ~~will~~ will not reduce the quantity of knowledge available to others. ✓

c. Oligopoly. ✓ There is some dominant sellers in the market. Also, ~~market~~ market information products (textbooks) are heterogeneous. ✓

d. As the scheme allows needy students to have the opportunity to study and buy textbooks, it is a policy which can ~~enhance~~ reduce the difference in human capital which is a source of income inequality, so it equalize opportunity for needy students to compete the society ^{after education} in it. ✓

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Enhance equity in terms of equalizing opportunity and reduce difference in human capital.

Yet, as equity is a normative statement involves the judgement if we can achieve equity or in favor of equality opportunity but not in terms of other value or principle.

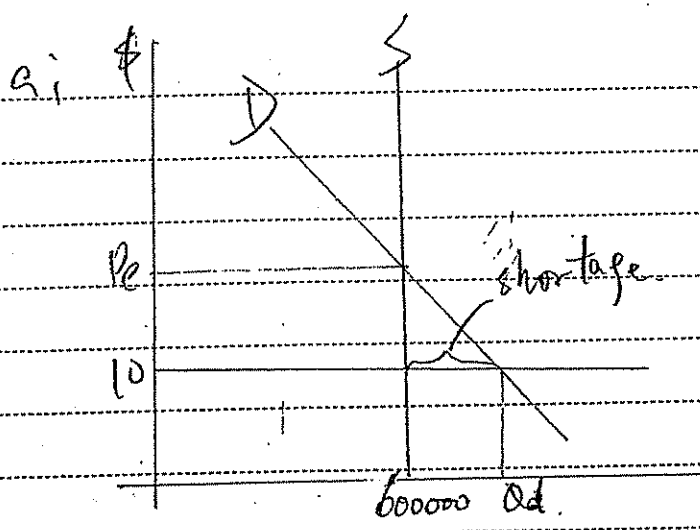
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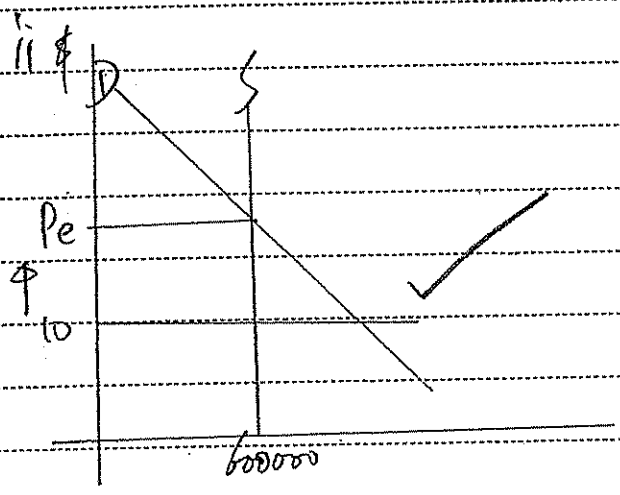
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12. In November 2010, the animated version of the Riverside Scene at the Qingming Festival (清明上河圖) was exhibited in Hong Kong. 600 000 tickets were sold at \$10 each through the outlets and the Internet. Tickets were sold out within a short period of time. Many citizens complained that they could not purchase any tickets.

- (a) (i) Illustrate the above phenomenon in a demand-supply diagram. (3 marks)
- (ii) Suggest TWO measures which would help relieve the above problem. Illustrate your answers in TWO separate diagrams. (6 marks)
- (b) Some people paid \$200 to buy a ticket from touts (黃牛黨). (1 mark)
- (i) State the function of price in the above case. (1 mark)
- (ii) "The government should raise the ticket price so as to kick out touts." Evaluate this proposal. (4 marks)



There is shortage in the market as price is set below equilibrium, so some people cannot buy the tickets.



~~The government can~~
The price can be rise from \$10 to equilibrium level, so no shortage will occur.

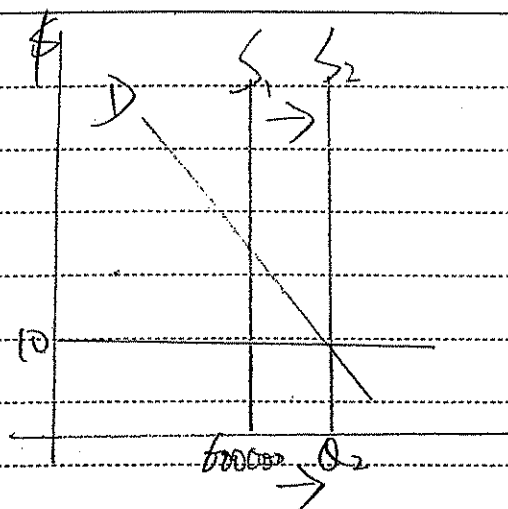
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The amount of tickets can be increased from 10000 to Q_2 , so no shortage will occur.

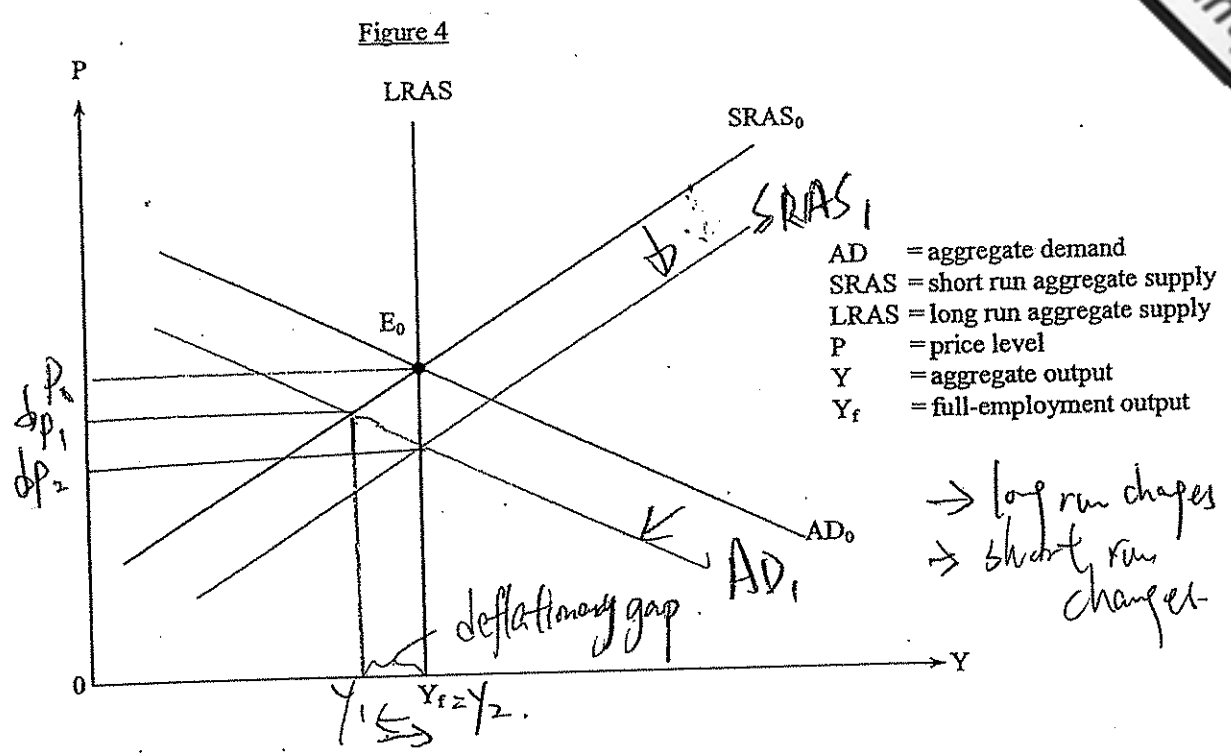
b i. Distributing ~~to~~ outputs. Under free market, price determines who can get the good (tickets) and who cannot. Ticket is given to people who are willing ^{to} pay the highest price for it. (\$200) and able.

ii. Due to imperfect market information, the government may not know the equilibrium price level, hence, if ^{the} price ^{is} increase in price, the price is still below equilibrium, ^{after} tickets cannot be kick out.

Also, a rise in price may reduce poor people's opportunity to watch the animation as their full cost rise. Originally, they have advantage in engaging in non-price competition ^{to} get the tickets as their ^(cheaper) full cost is lower than rich, so they are more able to watch animation as full cost is lower, but after the rise in price, the full cost may rise, so they ^{lose} the chance to watch animation.

Also, bots can purchase tickets in bulk to ~~hold~~ store up tickets and then sell them at even higher price due to the ~~enormous~~ large market share.

13. Figure 4 shows the aggregate supply and aggregate demand curves of an economy.



AD = aggregate demand
 SRAS = short run aggregate supply
 LRAS = long run aggregate supply
 P = price level
 Y = aggregate output
 Y_f = full-employment output

Suppose the initial equilibrium is at E₀.

- (a) Why is the short run aggregate supply curve upward-sloping? (3 marks)
- (b) Suppose the economy suffers from a bursting of the assets bubble so that asset prices fall drastically. With the aid of Figure 4, explain how the short run equilibrium output and price levels of the economy will change. (6 marks)
- (c) With the aid of Figure 4, explain how market forces will help restore the output level to Y_f. (5 marks)

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Q. There is sticky cost effect. In short run, input cost is sticky as it is fixed by contract. When the price level rise, output price rise and input cost remain sticky, hence, producer will increase output to rise profit, so aggregate output supplied rise with price.

Also, there is misperception effect. In short run, some input owners and producers may mistake a rise in nominal price as a rise in relative price. So the misperception due to imperfect information induce them to supply more and aggregate output supplied rise with price.

6

b. As asset price fall, it is risky for people to hold income-generating assets, hence, the asset money demand ~~for~~ increase, which in turn increase nominal interest rate, holding inflation rate remain unchanged, the real interest rate rise, so cost of consumption and investment rise. ~~As private consumption~~ Also, firms are pessimistic ~~possibility~~ on business future, so they will reduce production scale. As private consumption expenditure and gross investment expenditure fall, aggregate demand fall. In short run, both price levels and short run equilibrium output decrease.

c. Since short run equilibrium output is lower than ~~at~~ full employment level, there's deflationary gap. In long run, as all input and output prices are fully flexible, the excess supply of resources will pull down the input price and lead to a rise in short run aggregate supply until short run equilibrium output is restored to full employment level of Y_f and close the deflationary gap. So price will further fall.

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25% ⇒ 20%

14. The following table shows the balance sheet of the banking system of an economy:

Assets (\$ million)		Liabilities (\$ million)	
Reserves	1 000	Deposits	4 000
Loans	3 000		

Suppose the public in this economy always holds \$500 million cash and the banking system never holds excess reserves.

- (a) Calculate the monetary base and money supply of the economy. (2 marks)
- (b) Suppose the central bank lowers the minimum reserve ratio of the banking system by 5%.
 - (i) Explain whether the monetary base of the economy changes. (2 marks)
 - (ii) Calculate the new money supply. Show your working. (4 marks)
- (c) According to the quantity theory of money, explain how the above change in money supply affects the general price level in the long run. (4 marks)

a Monetary base = $\$4000$ million + $\$500$ million
 = $\$4500$ million ✓
 Money supply = $\$4000$ million + $\$500$ million
 = $\$4500$ million. ✓

b i. No as no ^{new} currency is issued or abolished, the fall ~~change~~ in minimum reserve ratio only ~~change~~ the maximum banking multiplier.

ii New minimum reserve ratio = $\frac{\$1000}{\$4000} \times 100\% = 25\%$
 = 20%
 Maximum banking multiplier = $\frac{1}{20\%} = 5$

The new money supply = $\$500$ million + $\$1000$ million $\times 5$
 = $\$5500$ million. ✓

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C. In quantity theory of money,

$$M \cdot V = P \cdot Y$$

~~It is~~ V is a constant while Y is also a constant at full employment level in long run.

So a increase in money supply by 22.22% ($\frac{5500-4500}{4500} \times 100$) will bring in the same percentage of 22.22% increase in the general price level in long run.

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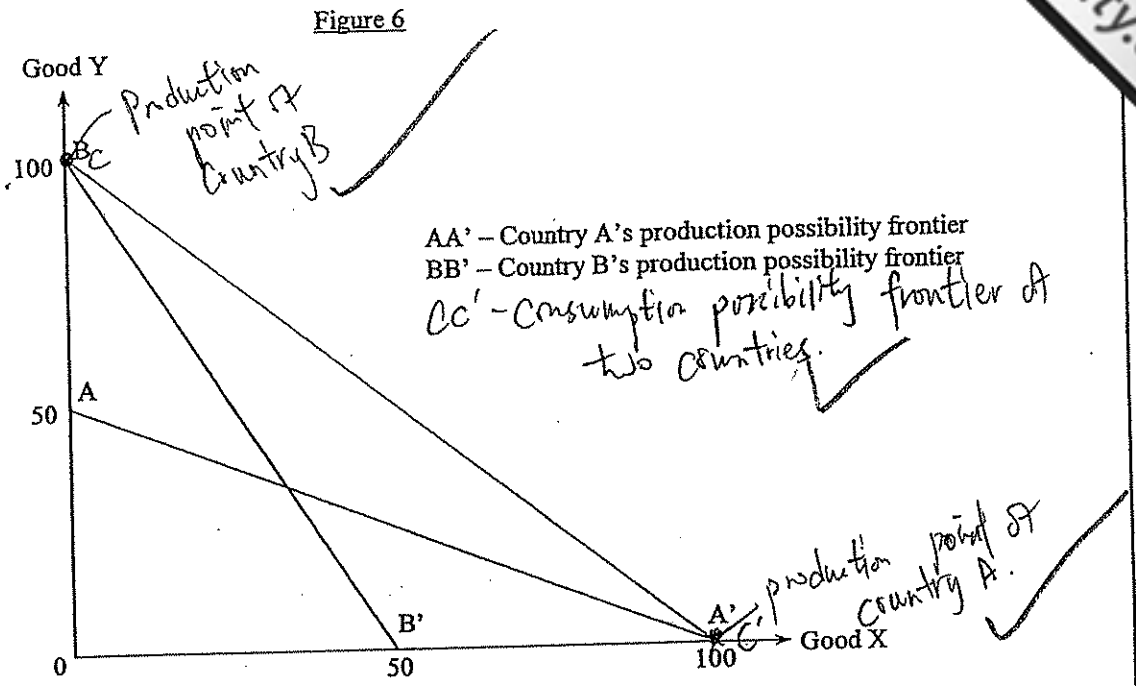
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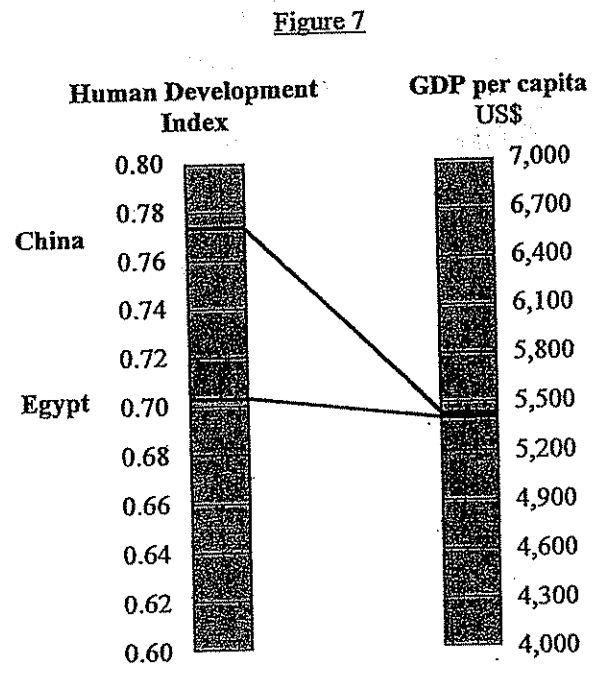
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16. (a) Figure 6 shows the production possibility frontiers of Country A and Country B.



- (i) Explain whether Country A has an absolute advantage in producing Good X. (2 marks)
- (ii) Suppose both countries engage in complete specialization according to their comparative advantages. Given the terms of trade is $1X = 1Y$, draw on Figure 6 the production points and consumption possibility frontiers of Country A and Country B. (4 marks)
- (iii) Based on your answer in (ii), explain whether both countries can gain from trade. (2 marks)

(b) Figure 7 shows the Human Development Index and GDP per capita of China and Egypt in 2009.



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- (i) Suggest TWO reasons to explain why China has a significantly higher Human Development Index despite having a similar GDP per capita to Egypt.
- (ii) The GDP per capita of China increased sharply in the last decade. Explain with TWO reasons why the increase in the GDP per capita may overstate the improvement of general living standard. (4 marks)

Q i. As there is no information about two countries' factor endowments, we cannot conclude whether Country A has absolute advantage in producing Good X. ✓

2

iii Country A can gain by consuming more of Good Y beyond its own PPF while Country B can gain by consuming more of Good X beyond its own PPF. Hence both countries can gain by increasing its consumption level. ✓

2

~~GDP measure economic growth while GDP per capita measure economic growth while HDI measure economic development. While economic growth only focus on economic aspect, economic development has broader wider scope by covering education and health aspect.~~

bi Health condition and medical care of people in China is better ^{than Egypt} so they can enjoy healthier and longer life which in turn ^{or rise} ~~is~~ their living standard, productivity and life expectancy of ~~both~~ ^{more than that of} ~~the~~ ^{the} Egypt. Also, the educational attainment of people in China is higher ^{than Egypt} due to higher adult literacy rate and educational index, so their productivity and living standard is higher ^{than} Egypt. ✓

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END OF PAPER

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

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bii Higher GDP ~~at~~ per capita mean ~~for~~ greater economic growth. Economic growth means a rise in production activities, but more production activities will lead to environmental damage and pollution, so our living standard is actually lower.

Also, the use of new technologies ~~and~~ and machine will lead to economic growth. But it will ~~to~~ also lead to unemployment of unskilled workers, ~~so they will be~~ so the living standard of unemployed workers and their family is actually lower (being over estimated).

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Total: 113

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Section A (50 marks)

1. Peter borrowed a book from Mary and he promised to return the book with a bookmark to her a month later at her request. Explain why the bookmark could be regarded as "interest" to both Peter and Mary. (4 marks)

To Peter, Peter borrowed a book from Mary, the interest is the earlier availability of good or resources for Peter.

To Mary, she lend the book to Peter and she will receive a bookmark when Peter return the book, therefore, the interest is the compensation for delaying consumption for Mary.

2. A Chinese car manufacturer acquired a Swedish car manufacturer in 2010. Explain which type of integration was involved in this case and state **THREE** possible motives for this type of integration. (5 marks)

It is a horizontal integration. They produce the same good or on the same production stage.

The first motive is it can increase its market share.

The second motive is it can turn the competitor into business partner.

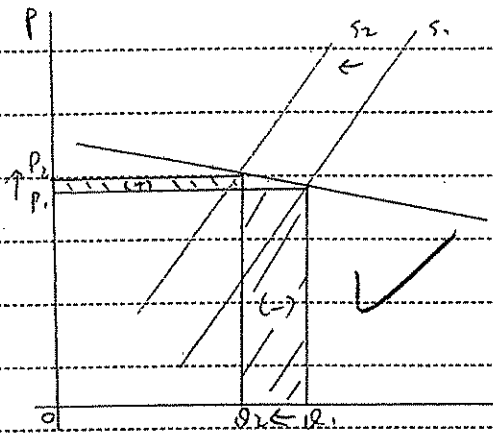
The third motive is it can reduce the duplication of facilities.

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3. The earthquake in Japan greatly damaged the production facilities of memory products like Secure Digital (SD) cards. As a result, the prices of these products rose. With the aid of a diagram, explain under what condition the total expenditure of Japanese consumers on the memory products would fall. (7 marks)



The earthquake damaged the production facilities, and lead to the fall in supply of memory products. The price will rise and quantity transacted will fall. When the demand is elastic, when the rise in price, the % increase in price is smaller than the % decrease in quantity demanded. Therefore, the gain in revenue due to the rise in price will be smaller than the loss in revenue due to the fall in quantity. So the total expenditure of Japanese consumers on the memory products will fall when price increases.

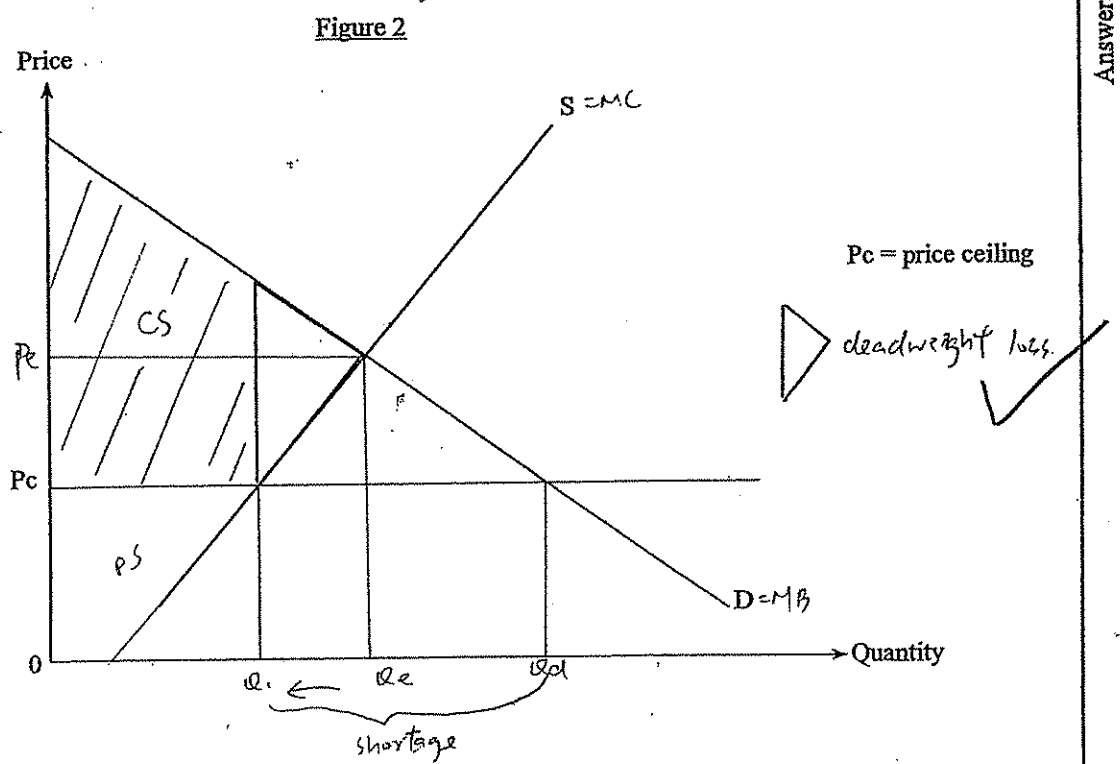
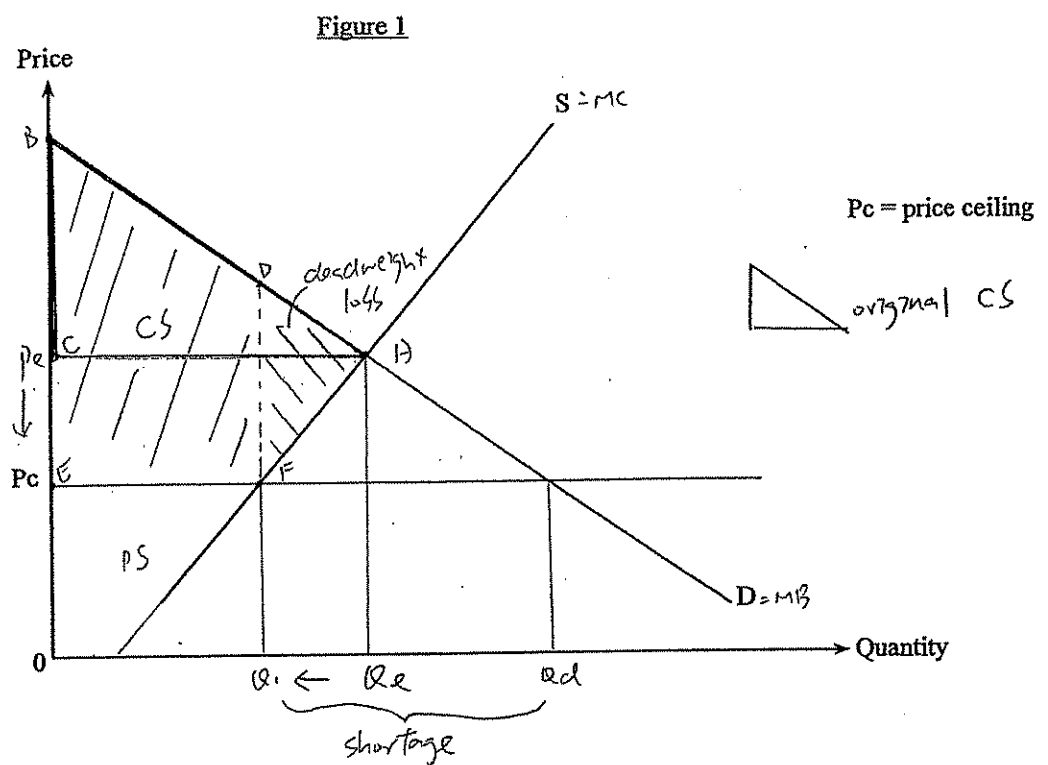
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7

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4. (a) What is "deadweight loss"?
- (b) A teacher said, "An effective price ceiling may increase the consumer surplus." His student replied, "If this is the case, the price ceiling may enhance economic efficiency!"
- (i) Do you agree with the teacher? Illustrate your answer in Figure 1. (3 marks)
- (ii) Do you agree with the student? Explain your answer with the aid of Figure 2. (5 marks)



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(a) Deadweight loss is the loss when the government fails to allocate scarce resources. When the quantity is greater or lower than the efficient output level where $MB=MC$, there will be deadweight loss.

(b)(i) No, I don't agree. It is because when the effective price ceiling is introduced, the consumer surplus will change from ABC to BDEF. But the change is uncertain.

(ii) No, I don't agree. When the effective price ceiling is introduced, the price will fall and quantity transacted will fall. And shortage will occur. At the new quantity transacted (Q_1), the marginal benefit is higher than marginal cost of producing it. Therefore, a deadweight loss occurs from underproduction i.e. the quantity transacted is smaller than the efficient output level $MB=MC$.

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5. Mr. Richardson, a British civil engineer, has worked for a large Hong Kong construction company in the past few years. He is earning an annual income of HK\$800 000 and he remits part of his income to his family in Britain. Is Mr. Richardson's income counted in HK's gross domestic product (GDP)? Explain your answer. (3 marks)

Yes. Mr Richardson's income will count in HK GDP. It is because he works for a Hong Kong construction company for few years. The company is HK resident producing goods. Therefore, it should be count in HK's GDP.

2

6. The following is a news report about Economy A.

Skilled construction workers are in great demand after the launch of the construction project of a new high-speed railway system. A government official has announced the introduction of a labour importation scheme to meet the need for skilled workers.

Suppose the imported workers do not replace any of the domestic workers. Explain how the unemployment rate will be affected by the scheme. (4 marks)

unemployment rate = $\frac{\text{no. of unemployed person}}{\text{labour force}} \times 100\%$

The imported workers will increase the labour force. But they do not replace the domestic workers. Therefore, the no. of unemployed workers will remain unchanged when the increase in labour force is greater than the increase in unemployed person. The unemployment rate will fall.

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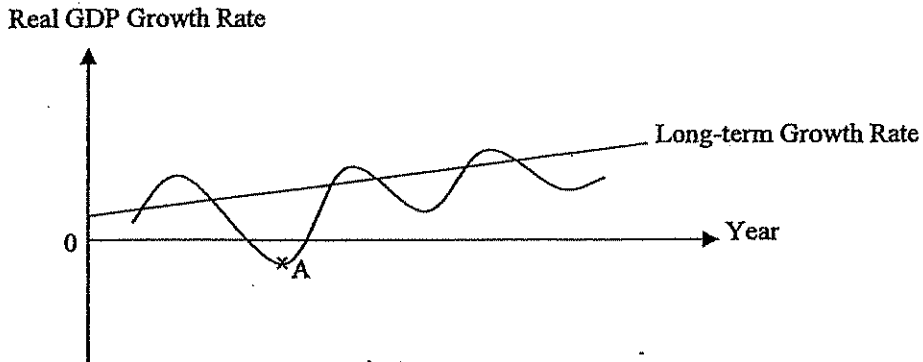
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7. Refer to the business cycle shown in Figure 3. Identify the phase which point A is in. Apart from the information about the real gross domestic product (GDP) growth rate in this phase, give **THREE** general economic phenomena which occur in this phase. (4 marks)

Figure 3



Point A is at slump. During this phase, the unemployment rate is high. There is no incentive to invest and the aggregate demand is low.

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8. Demand deposits can be regarded as money. Explain which **TWO** functions of money they can perform. (4 marks)

As a medium of exchange. They can buy good using money. It is generally accepted as a medium of exchange for settling transactions and debts.

As a store of value. It can store purchasing power for future consumption and accumulate wealth.

Answers written in the margins will not be marked.

9. Country A and Country B possess the same amount of resources. While Country A uses half of its resources in producing food and half in producing computers, Country B uses one-third of its resources in producing food and two-thirds in producing computers. Their total output in a year is shown below.

	Food (units)	Computers (units)
Country A	100	50
Country B	200	100

Explain whether Country B has

- (a) an absolute advantage; and
 (b) a comparative advantage

in producing food.

(6 marks)

(a) Country B has an absolute advantage in producing food because Country B can produce more food than Country A with the same amount of resources. Country B can produce 200 food but Country A can produce only 100 food.

(b) Country A can produce 50 food and 25 computer when using half of its resources. And Country B can produce 200/3 food and 200/3 computer.

$$\text{OC of producing food of A} = 25/100 = 0.25$$

$$\text{OC of producing food of B} = (200/3) \div (200/3) = 1$$

\therefore Country B will not have a comparative advantage in producing the food since it gives up more computers than Country A when producing the food.

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10. Suppose the US dollar depreciates against the Euro. Under the linked exchange rate system, how will the following items be affected?

- (a) The total number of Hong Kong tourists travelling to European countries
- (b) The prices (in Euro) of Hong Kong toys exported to Europe
- (c) The total expenditure (in Hong Kong dollar) of Hong Kong on imported European automobiles

(3 marks)

US dollar depreciate against Euro. So HK dollar depreciates against the Euro.

(a) The total number of HK tourists travelling to European will fall.

(b) The price (in Euro) of HK toys exported to Europe will decrease.

(c) The total expenditure (in HK dollar) of HK on imported

European automobiles will rise, fall or remain unchanged depend on the elasticity of demand.

END OF SECTION A

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Section B (54 marks)

11. The prices of textbooks for senior secondary education have increased sharply because textbook publishers have to publish new textbooks for the new curriculum.
- (a) The production of textbooks involves various experts, including authors, editors, graphic designers, etc. What economic principle is illustrated? Give **THREE** reasons to explain why this principle can raise labour productivity. (4 marks)
 - (b) Explain whether the knowledge in the textbooks is a public good. (3 marks)
 - (c) In Hong Kong, to which type of market structure do the publishers belong? State **TWO** features of this type of market structure. (3 marks)
 - (d) Under the School Textbook Assistance Scheme (STAS), needy students are granted subsidies to cover the costs of textbooks and miscellaneous school-related expenses. Explain how STAS can enhance equity in Hong Kong society. (4 marks)

(a) It illustrates the division of labour principle. During division of labour, the workers can become more skillful since they do the job all the time as practice makes perfect. The time for training workers is saved. Because the workers need to learn one job only. The time for adjusting to different tasks is saved as workers need to concentrate on one job only.

(b) Yes. It is a public good. The seller's needs not prevent the non-payers from consuming it at an affordable cost. The consumption of it will not reduce the quantity available to others.

(c) The market structure is monopolistic competition. They are small and are not associated with each other. The entry of publishers is free. There is no barriers.

(d) Equity means the fairness in society. It concerns the distribution of the income pie. Needy students have not enough of money to pay for the school textbook. The STAS can enhance the resource allocation to be more fairer, and let the

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poor students have the opportunity to have school textbooks.

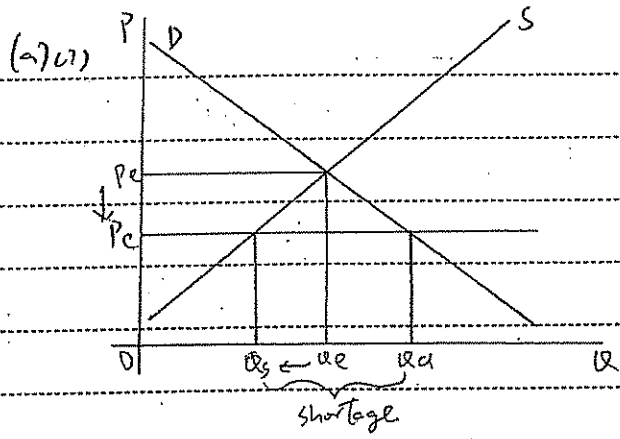
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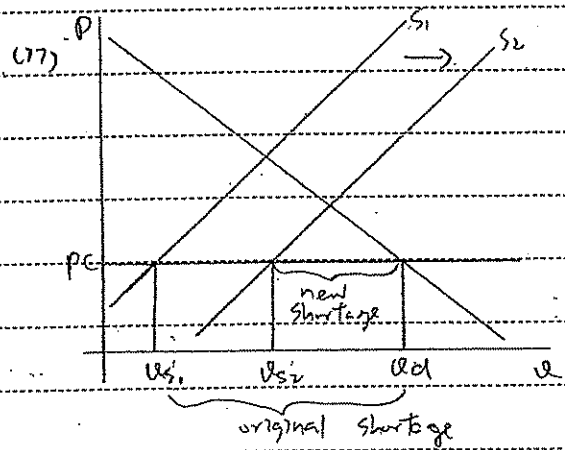
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12. In November 2010, the animated version of the Riverside Scene at the Qingming Festival (清明上河圖) was exhibited in Hong Kong. 600 000 tickets were sold at \$10 each through the outlets and the Internet. Tickets were sold out within a short period of time. Many citizens complained they could not purchase any tickets.

- (a) (i) Illustrate the above phenomenon in a demand-supply diagram. (3 marks)
- (ii) Suggest TWO measures which would help relieve the above problem. Illustrate your answers in TWO separate diagrams. (6 marks)
- (b) Some people paid \$200 to buy a ticket from touts (黃牛黨). (1 mark)
- (i) State the function of price in the above case. (1 mark)
- (ii) "The government should raise the ticket price so as to kick out touts." Evaluate this proposal. (4 marks)



When the price set below the equilibrium, the quantity demanded will be greater than the quantity supplied. Therefore shortage will occur.



The government can increase the supply of the tickets. Therefore, when the price remain unchanged, the shortage will decrease from $(Qd - Qs_1)$ to $(Qd - Qs_2)$.

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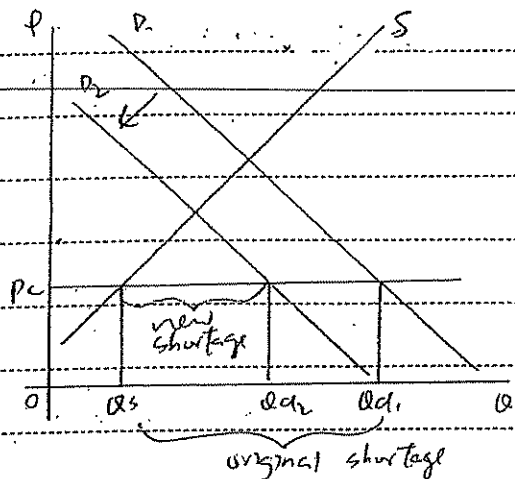
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(a) (77)



The government can introduce another festival for HK people so as to decrease their demand for the tickets. And the shortage will decrease from $(Qd_1 - Qs)$ to $(Qd_2 - Qs)$

(b) (7) The function of price is allocating resources.

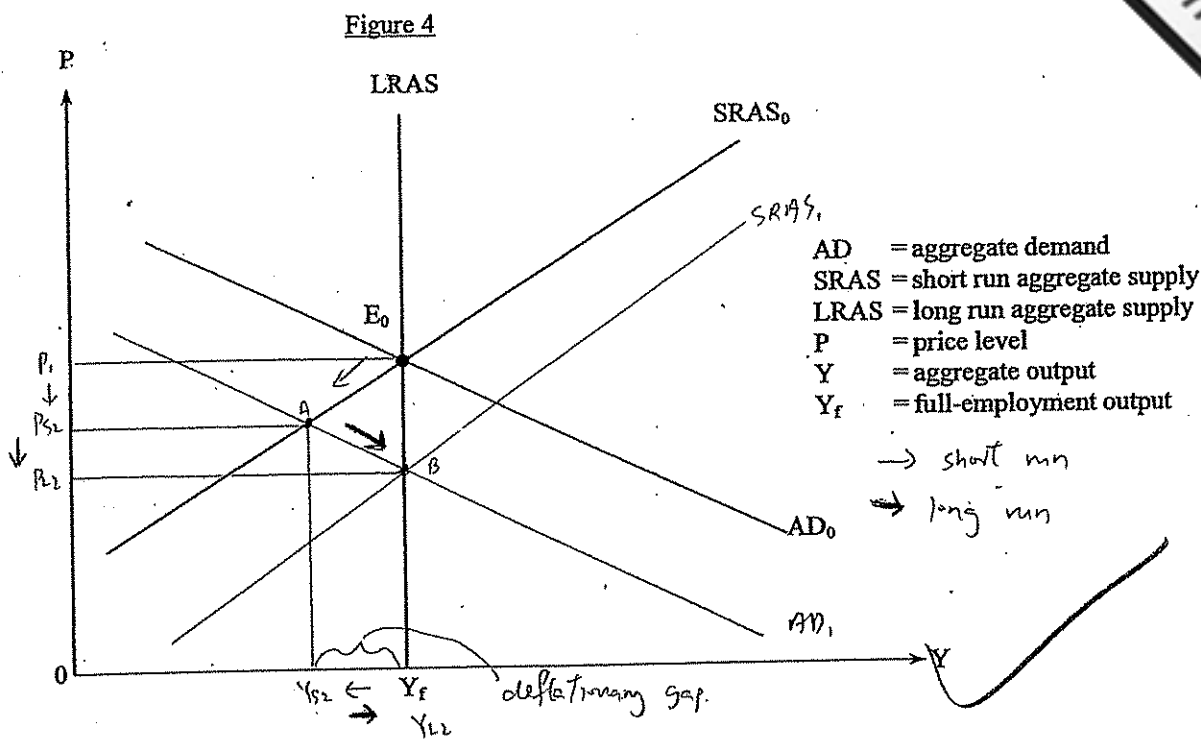
(77) Government raise the price will not necessarily knock out the tickets. It is because when the government raise the price, there is also shortage. Since quantity demanded is greater than the quantity supplied. And people will also buy ticket from the tickets. And the government does not ~~save~~ the exact price that will rise.

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13. Figure 4 shows the aggregate supply and aggregate demand curves of an economy.



Suppose the initial equilibrium is at E_0 .

- Why is the short run aggregate supply curve upward-sloping? (3 marks)
- Suppose the economy suffers from a bursting of the assets bubble so that asset prices fall drastically. With the aid of Figure 4, explain how the short run equilibrium output and price levels of the economy will change. (6 marks)
- With the aid of Figure 4, explain how market forces will help restore the output level to Y_f . (5 marks)

(a) It is because the misperception effect. When the price level increases, the producers will mistake a rise in nominal price as a rise in relative price. Therefore, they will supply more. And so the aggregate output supplied increases with price. It is also because the sticky cost effect.

(b) The bursting of asset bubble will decrease the demand for investment. Therefore, the aggregate demand will decrease. In the short run, the price level will fall from P_1 to P_2 and output will fall from Y_f to Y_{s2} .

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(c) When Y_s is lower than Y_p , there is a deflationary gap.
The decrease in supply of resources will decrease the input price. In the long run, the flexible cost replace sticky cost.
And the fall in input price will shift the SRAS curve to the right. And the price will fall until the output level restored to its ~~high~~ employment level.

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14. The following table shows the balance sheet of the banking system of an economy:

Assets (\$ million)		Liabilities (\$ million)	
Reserves	1 000	Deposits	4 000
Loans	3 000		

Suppose the public in this economy always holds \$500 million cash and the banking system never holds excess reserves.

- (a) Calculate the monetary base and money supply of the economy. (2 marks)
- (b) Suppose the central bank lowers the minimum reserve ratio of the banking system by 5%.
- (i) Explain whether the monetary base of the economy changes. (2 marks)
- (ii) Calculate the new money supply. Show your working. (4 marks)
- (c) According to the quantity theory of money, explain how the above change in money supply affects the general price level in the long run. $MV = PY$ (4 marks)

(a) monetary base = $(\$500 + 1000)$ million
 $= \$1500$ million

money supply = $(\$500 + 4000)$ million
 $= \$4500$ million

(b) (i) It is not change. It is because the reserve will not change. It will change only if the people withdraw or deposit. And the cash held by non-bank public will remain \$500 million.

(ii) new reserve ratio = $1000 \div 4000 \times 100\% = 25\%$
 $= 20\%$

new money supply = $\$500 + 1000 \times (1 / 20\%)$
 $= \$5500$ million

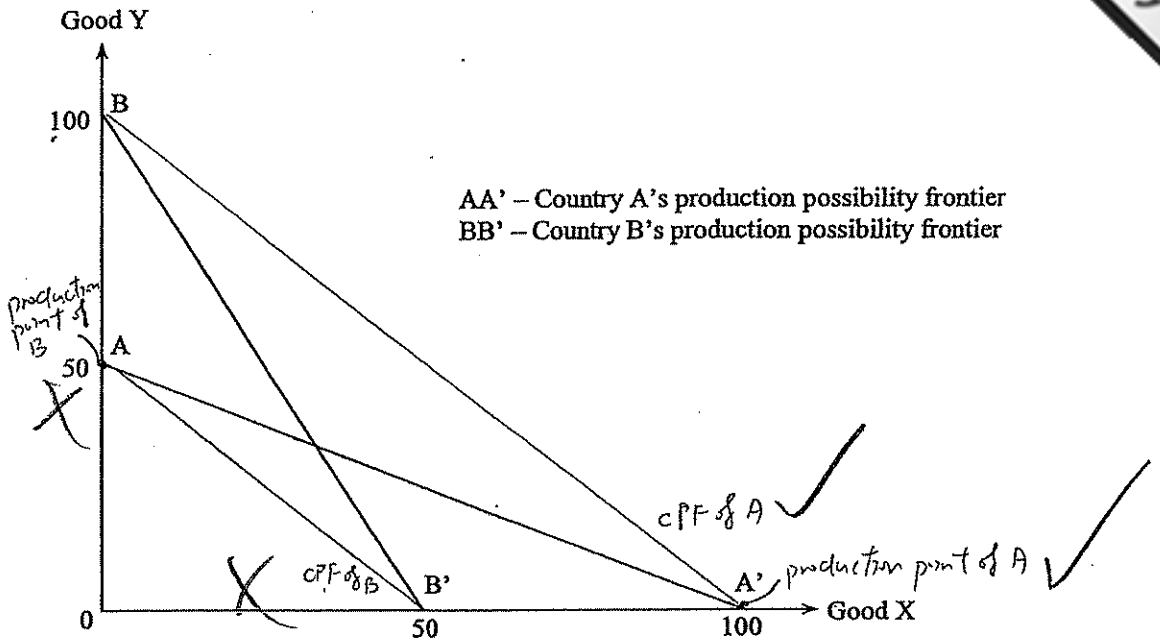
(c) According to the quantity theory of money, $MV = PY$. There is an increase in the money supply. But V is constant and $Y = Y_f$ in the long run, the increase in money supply will only affect the price level. The increase in money supply will bring the same percentage change in the price level.

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16. (a) Figure 6 shows the production possibility frontiers of Country A and Country B.

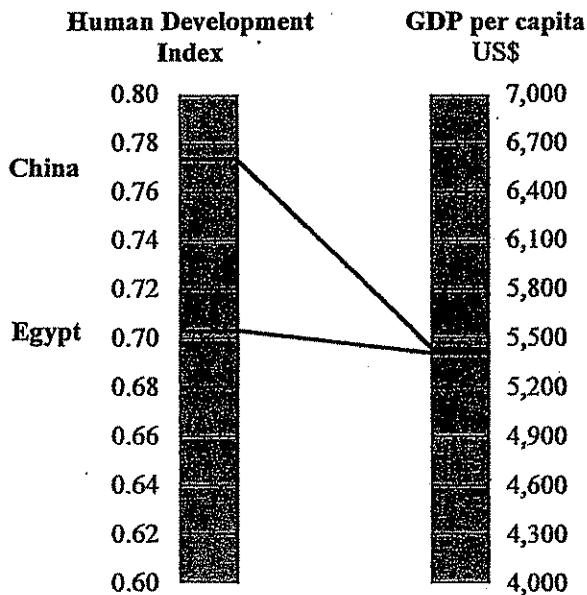
Figure 6



- (i) Explain whether Country A has an absolute advantage in producing Good X. (2 marks)
- (ii) Suppose both countries engage in complete specialization according to their comparative advantages. Given the terms of trade is $1X = 1Y$, draw on Figure 6 the production points and consumption possibility frontiers of Country A and Country B. (4 marks)
- (iii) Based on your answer in (ii), explain whether both countries can gain from trade. (2 marks)

(b) Figure 7 shows the Human Development Index and GDP per capita of China and Egypt in 2009.

Figure 7



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- (i) Suggest TWO reasons to explain why China has a significantly higher Human Development Index despite having a similar GDP per capita to Egypt.
- (ii) The GDP per capita of China increased sharply in the last decade. Explain with TWO reasons why the increase in the GDP per capita may overstate the improvement of general living standard. (4 marks)

(a) (i) Country A has an absolute advantage in producing good X, since it can produce more good X than country B with the same amount of resources.

(ii) Both country cannot gain from trade, because they cannot consume beyond to their PPF.

(b) (i) It is because China has a higher life expectancy at birth. People would be more healthy in China and living standard will rise. Also, China has a higher education attainment. People in China has a higher enrolment in school and literacy rate. So their living standard would be higher than Egypt.

(ii) There are other factors affect the living standard. The GDP per capita does not involve the measurement of human's leisure. And if people have less leisure, their living standard will be overstated. And if the pollution cause by the rise in GDP per capita increase, it will overstate our living standard.

Total: 82

END OF PAPER

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

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Section A (50 marks)

1. Peter borrowed a book from Mary and he promised to return the book with a bookmark to her a month later at her request. Explain why the bookmark could be regarded as "interest" to both Peter and Mary. (4 marks)

Interest is the cost pay for earlier consumption.
~~And it can also be the price of earlier consumption.~~
Peter gives the bookmark to Mary: the bookmark serves as price. Peter need to pay for his earlier consumption. His cost for earlier consumption is a bookmark.

And for Mary, the interest is the receive of later consumption. Just like the interest you receive from putting the deposit into to the bank. The bookmark is the something that Mary receive for later consumption.

2. A Chinese car manufacturer acquired a Swedish car manufacturer in 2010. Explain which type of integration was involved in this case and state THREE possible motives for this type of integration. (5 marks)

Horizontal integration. ✓

The firm can enjoy economy of scale.
(First.)

Second, the firm can reduce the competition as it turns competitor to partner. ✓

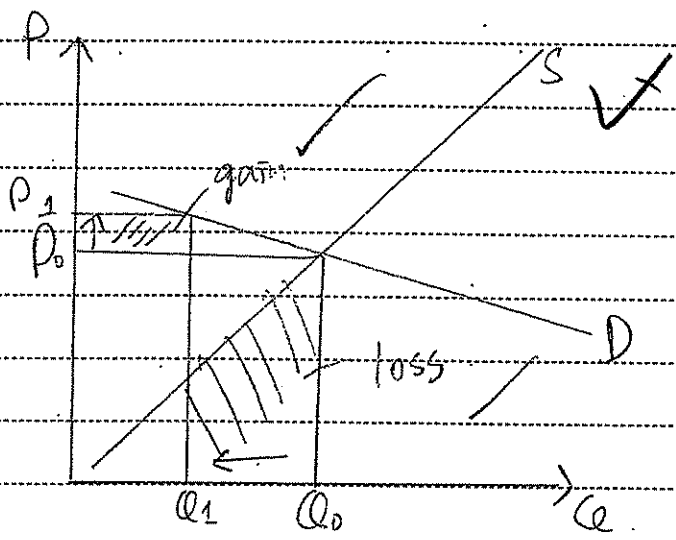
Third, the firm can have more market shares, so as to control the market price and change to a higher price. ✓

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3. The earthquake in Japan greatly damaged the production facilities of memory products like Secure Digital (SD) cards. As a result, the prices of these products rose. With the aid of a diagram, explain under what condition the total expenditure of Japanese consumers on the memory products would fall. (7 marks)



The expenditure of Japanese consumer.

As the earthquake in Japan greatly damaged the production facilities of memory products like Secure Digital cards, the prices of these products rose. If the demand of this memory products is elastic, the increase in price is smaller than the decrease in quantity transact, the total expenditure of Japanese consumers on the memory products would fall.

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4. (a) What is "deadweight loss"?

(b)

A teacher said, "An effective price ceiling may increase the consumer surplus."
His student replied, "If this is the case, the price ceiling may enhance economic efficiency!"

- (i) Do you agree with the teacher? Illustrate your answer in Figure 1. (3 marks)
- (ii) Do you agree with the student? Explain your answer with the aid of Figure 2. (5 marks)

Figure 1

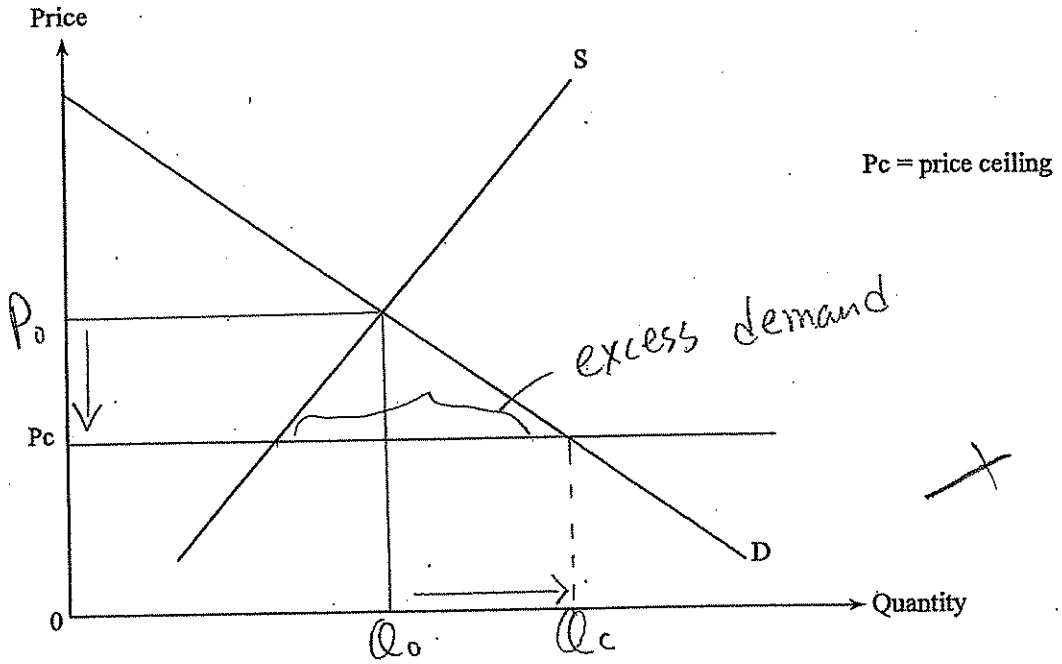
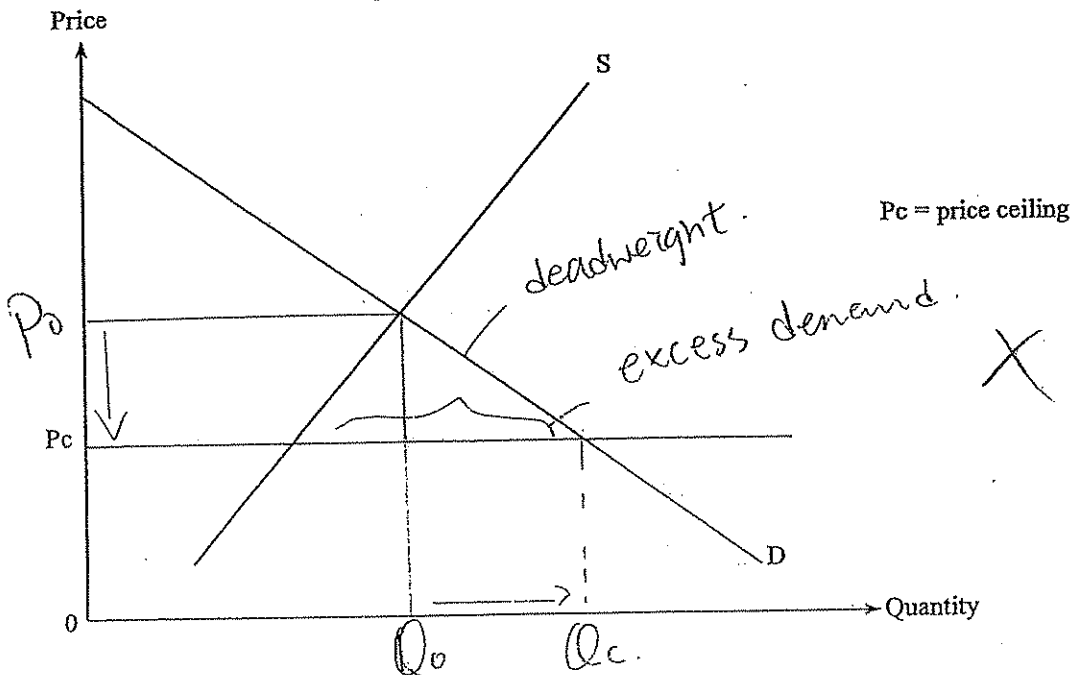


Figure 2



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Deadweight loss is the potential gain that cannot be captured.

b) Yes, If an effective price ce.

4b) I don't agree. As deadweight loss occur.

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5. Mr. Richardson, a British civil engineer, has worked for a large Hong Kong construction company in the past few years. He is earning an annual income of HK\$800 000 and he remits part of his income to his family in Britain. Is Mr. Richardson's income counted in HK's gross domestic product (GDP)? Explain your answer. (3 marks)

Yes. It is because Mr. Richardson has been worked for a large Hong Kong construction company for a few years. He provides current production. Therefore, his income is counted in HK's gross domestic product.

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6. The following is a news report about Economy A.

Skilled construction workers are in great demand after the launch of the construction project of a new high-speed railway system. A government official has announced the introduction of a labour importation scheme to meet the need for skilled workers.

Suppose the imported workers do not replace any of the domestic workers. Explain how the unemployment rate will be affected by the scheme. (4 marks)

$$\text{Unemployment rate} = \frac{\text{unemployment population}}{\text{labour force}} \times 100\%$$

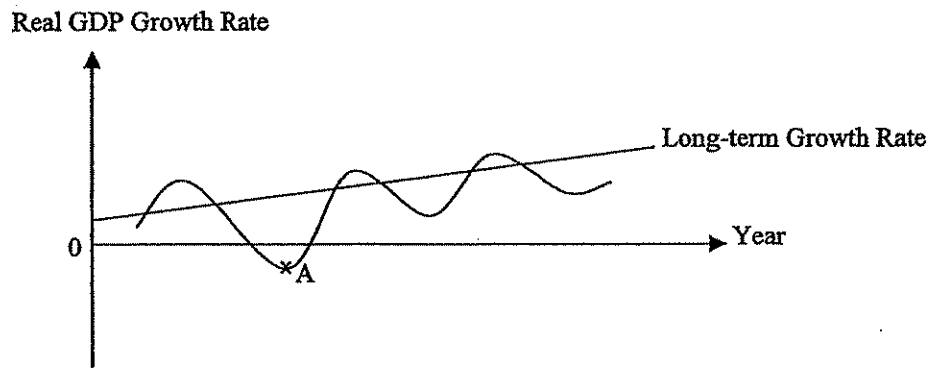
If the government official has announced the introduction of a labour importation ~~scheme~~ scheme to meet the need for skilled workers, the labour force increase. And as the imported workers don't replace any of the domestic workers, that means no unemployment population. When the labour (increasing) increase while the unemployment population remains change, then, the unemployment rate decrease.

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7. Refer to the business cycle shown in Figure 3. Identify the phase which point A is in. Apart from the information about the real gross domestic product (GDP) growth rate in this phase, give THREE general economic phenomena which occur in this phase. (4 marks)

Figure 3



Point A is at the trough. X

- 1) The inflation rate will keep on increasing. ✓
- 2) High unemployment rate. ✓
- 3) Decrease in GDP. X

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8. Demand deposits can be regarded as money. Explain which TWO functions of money they can perform. (4 marks)

First, medium of exchange. The Demand deposits can settle our payment in an exchange. ✓

Second, a store of value. Demand deposits can provide purchasing power for future use. ✓

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9. Country A and Country B possess the same amount of resources. While Country A uses half of its resources in producing food and half in producing computers, Country B uses one-third of its resources in producing food and two-thirds in producing computers. Their total output in a year is shown below.

	Food (units)	Computers (units)
Country A	100	50
Country B	200	100

$1F = 5C$

$1C = 2F$

Explain whether Country B has

$1F = \frac{1}{2}C$

$1C = \frac{1}{2}F$

- (a) an absolute advantage; and
- (b) a comparative advantage

in producing food.

(6 marks)

~~9a). Country B may or may not have an absolute advantage in producing food. It is because, Country A uses half of the resources in producing food and Country B uses one-third of the resources in producing food. They are not use the same amount of~~

9a). Country B has the absolute advantage in producing food, as Country B can produce 600 units of food when all resources are used to produce food while country A can only produce 500 units of food when all resources are used to produce food.

9b). Country B don't have a comparative advantage in producing food, as the cost of Country B produces 1 food is $\frac{1}{2}$ computers while the cost of country A produces 1 food is $\frac{1}{3}$ computers.

The comparative advantage means to produce 1 units of products with a lower cost.

Therefore, Country B don't have a comparative advantage.

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10. Suppose the US dollar depreciates against the Euro. Under the linked exchange rate system, how will the following items be affected?

- (a) The total number of Hong Kong tourists travelling to European countries
- (b) The prices (in Euro) of Hong Kong toys exported to Europe
- (c) The total expenditure (in Hong Kong dollar) of Hong Kong on imported European automobiles

(3 marks)

10a). Decrease as \$HK will also depreciates against the Euro.

10b). Decrease as \$HK depreciates against the Euro.

10c). Decrease as \$HK is depreciates, more \$HK are need to import European automobiles. The demand decrease so the total expenditure decrease.

END OF SECTION A

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Section B (54 marks)

11. The prices of textbooks for senior secondary education have increased sharply because textbook publishers have to publish new textbooks for the new curriculum.
- (a) The production of textbooks involves various experts, including authors, editors, graphic designers, etc. What economic principle is illustrated? Give **THREE** reasons to explain why this principle can raise labour productivity. (4 marks)
- (b) Explain whether the knowledge in the textbooks is a public good. (3 marks)
- (c) In Hong Kong, to which type of market structure do the publishers belong? State **TWO** features of this type of market structure. (3 marks)
- (d) Under the School Textbook Assistance Scheme (STAS), needy students are granted subsidies to cover the costs of textbooks and miscellaneous school-related expenses. Explain how STAS can enhance equity in Hong Kong society. (4 marks)

11a). Division of labour.

First, practice makes perfect. Workers do the same work everyday, they become more skilful. Labour productivity raise. Second, it saves time in training and moving around operation. As the workers have all know how to work for their jobs.

Third, can choose the most suitable person for the job as the workers are all good for one particular skill.

11b). Yes. It is a public good. Public good is good that can be consumed by many individuals at the same time and will not affect the others. The knowledge in the textbooks can be consumed by many individuals at the same time without affecting the others.

11c) It is a monopolistic competition. There are many buyers and sellers. Also the sellers are price follower.

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11d). STAS can make the equity in Hong Kong Society be more even. It is because STAS is some kind of subsidies for needy students that means the people from lower income group. The lower income family get the subsidies and can have more money for consumption. So, the equity in Hong Kong Society should be more even under the STAS.

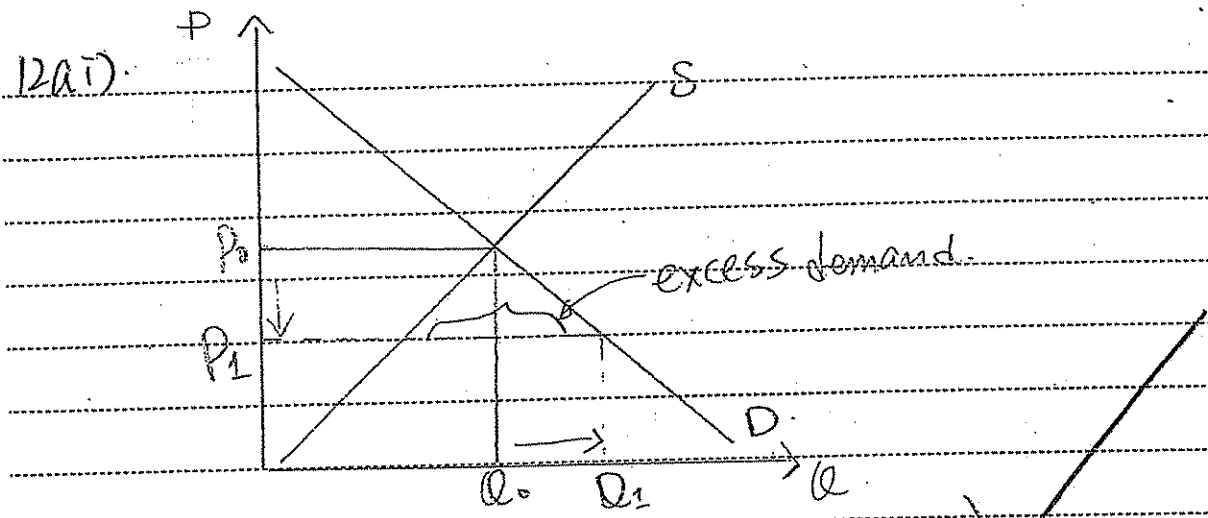
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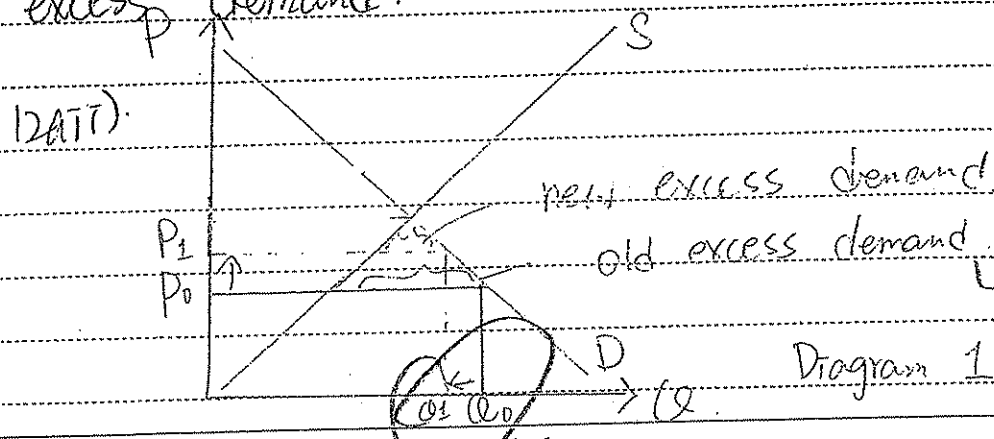
12. In November 2010, the animated version of the Riverside Scene at the Qingming Festival (電子明土河圖) was exhibited in Hong Kong— 600 000 tickets were sold at \$10 each through the outlets and the Internet. Tickets were sold out within a short period of time. Many citizens complained they could not purchase any tickets.

- (a) (i) Illustrate the above phenomenon in a demand-supply diagram. (3 marks)
- (ii) Suggest **TWO** measures which would help relieve the above problem. Illustrate your answers in **TWO** separate diagrams. (6 marks)
- (b) Some people paid \$200 to buy a ticket from touts (黃牛黨).
 - (i) State the function of price in the above case. (1 mark)
 - (ii) "The government should raise the ticket price so as to kick out touts." Evaluate this proposal. (4 marks)



Ticket Sold for Riverside Scene at the Qingming Festival

As the price of the tickets are sold below the equilibrium price. The tickets were sold out within a short period of time. And there is excess demand.



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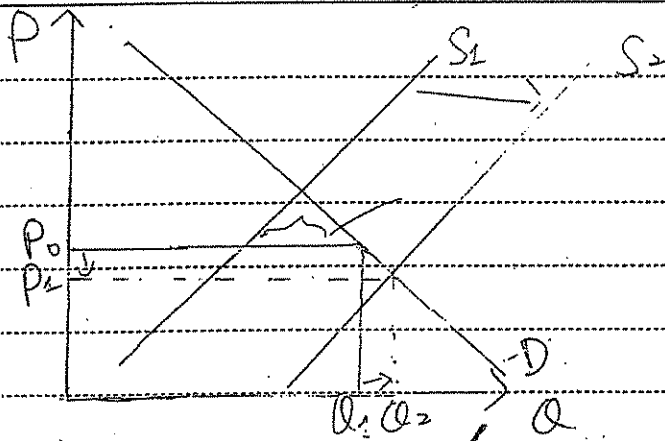


Diagram 2

In the diagram the government can ~~raise~~ the price. Then, the new excess demand will become smaller.

In the diagram 2, the government can increase the supply of the tickets so as to cover the demand in the market. Supply curve shifts to the right.

bi). Unit of account. It serves prices in terms of money.

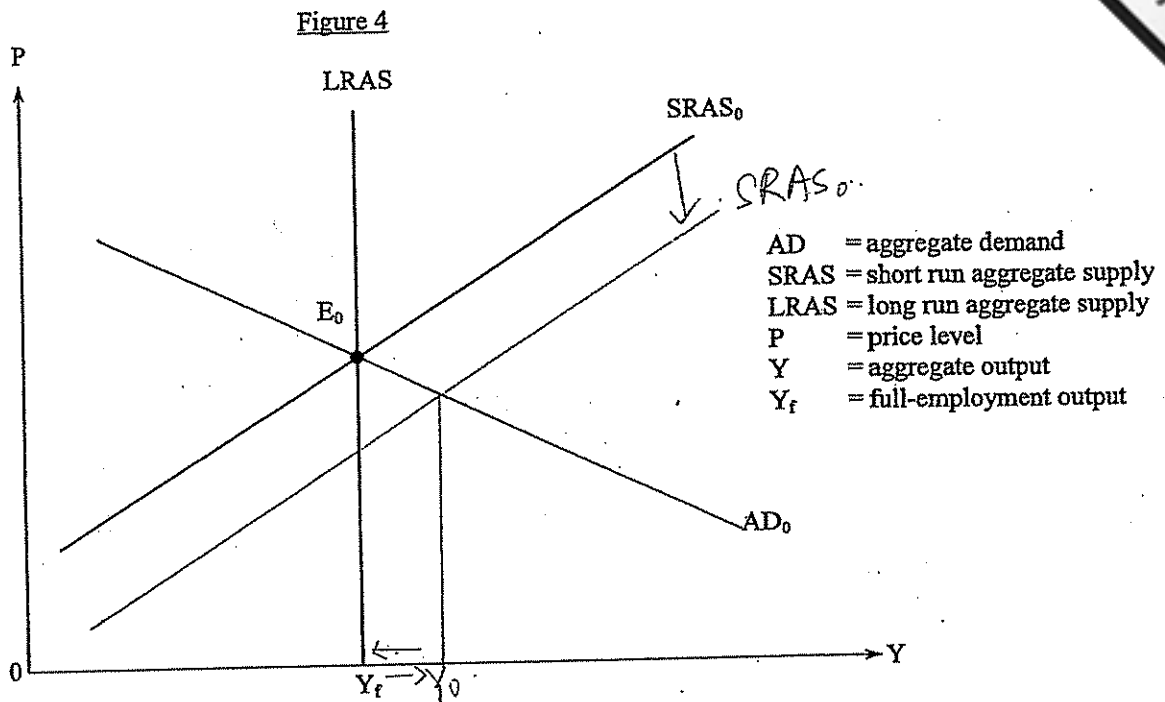
bi). The price ~~is~~ is set below the equilibrium, ~~many~~ many people buy the tickets at lower price and sell the tickets at a higher price. If the government raise the ticket price, the tourists would not easy to buy the tickets and so can't sell it at a higher price.

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13. Figure 4 shows the aggregate supply and aggregate demand curves of an economy.



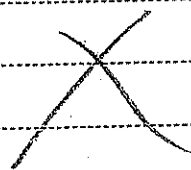
Suppose the initial equilibrium is at E₀.

- (a) Why is the short run aggregate supply curve upward-sloping? (3 marks)
- (b) Suppose the economy suffers from a bursting of the assets bubble so that asset prices fall drastically. With the aid of Figure 4, explain how the short run equilibrium output and price levels of the economy will change. (6 marks)
- (c) With the aid of Figure 4, explain how market forces will help restore the output level to Y_f. (5 marks)

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13a). It is because



13b). The economy suffers from a bursting of the assets bubble, the price level is under equilibrium, Deflationary gap occurred. The cost of production decrease, and supply

increase. The equilibrium output increase
the price levels decrease in the short.

13c). ~~The government will take expansionary policy.~~
The short run will face high cost again.

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14. The following table shows the balance sheet of the banking system of an economy:

Assets (\$ million)		Liabilities (\$ million)	
Reserves	1 000	Deposits	4 000
Loans	3 000		

Suppose the public in this economy always holds \$500 million cash and the banking system never holds excess reserves.

- (a) Calculate the monetary base and money supply of the economy. (2 marks)
- (b) Suppose the central bank lowers the minimum reserve ratio of the banking system by 5%.
 (i) Explain whether the monetary base of the economy changes. (2 marks)
 (ii) Calculate the new money supply. Show your working. (4 marks)
- (c) According to the quantity theory of money, explain how the above change in money supply affects the general price level in the long run. (4 marks)

14a). Monetary base = \$500. The money supply = $C_p + D_d$
 = 1000 + 4000
 = \$5000

14bi). No, it will not change, as the money is still the same amount. The monetary base of the economy is not increasing or decreasing.

14bii). Yes, it will increase, as if the minimum reserve ratio of the banking system is reduced. There is excess reserves, credit creation can occur. The maximum deposits may be increase. As Monetary base is $C_p + \text{Reserves} + \text{Deposits}$. Therefore, it may increase.

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bii). Excess Reserves.

$$1000 - 4000 \times 0.2$$

$$= \$ 200$$

New reserve ratio

$$= \frac{1000}{2000} \times 100\% = 5\%$$

$$= \dots = 20\%$$

The max deposits

$$= 200 \times \frac{1}{0.2}$$

$$= 1000$$

The new deposit

$$= 1000 + 4000$$

$$= \$ 5000$$

∴ The new money supply

$$= C_p + D_d$$

$$= 500 + 5000$$

$$= \$ 5500$$

c). The general price level may increase. As there is an increase in money supply. ~~More~~ People hold more money, the consumption increase, the general price level increase.

END OF SECTION B

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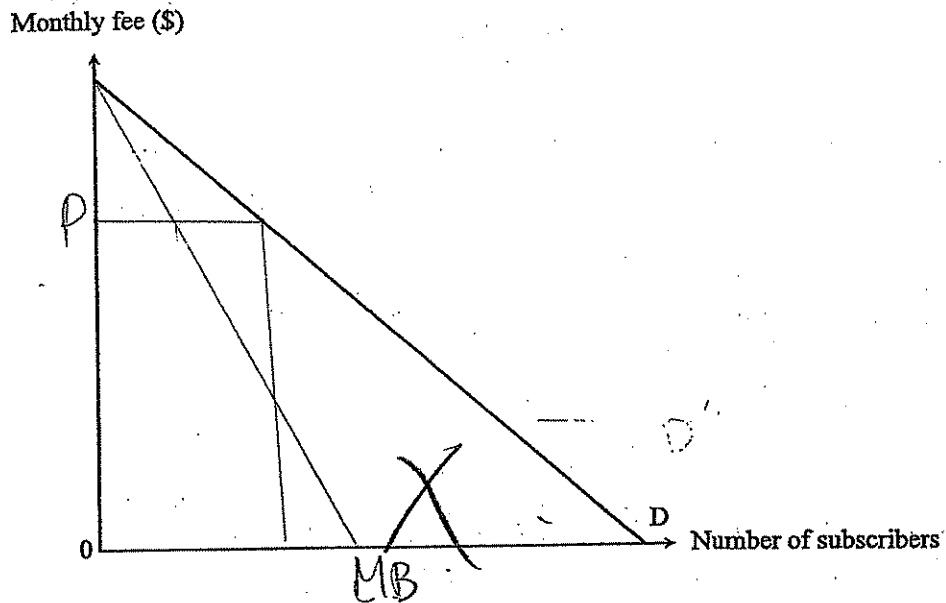
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Section C (16 marks) Answer any ONE question.

15. A pay TV channel spent a huge sum of money on purchasing exclusive rights to the broadcasting international sports event for one season.

- (a) Suppose the expense on the purchase of exclusive broadcasting rights was the only cost for the pay TV channel in providing the broadcast service. Figure 5 shows the market demand for the subscription to the sports programme.

Figure 5



- (i) With the aid of Figure 5, explain how the pay TV channel would set a price to maximize its profit under a uniform price arrangement. (5 marks)
- (ii) "The price charged for the programme would result in economic inefficiency." Do you agree? Explain. (3 marks)
- (b) Suppose during the period of promoting the programme subscription, the pay TV channel offered discounts only to new subscribers but not to the existing ones.
- (i) Explain whether the above practice constituted price discrimination. (4 marks)
- (ii) Other free-to-air broadcasters were not permitted to broadcast the event. This arrangement was criticized for the lack of competition. Suggest TWO reasons to justify the introduction of a competition policy. (4 marks)

15a)

~~_____~~

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15bi). Yes. I agree. It is because the price charged for the programme is set very high ~~in~~ in order to maximize the profit.

15bi). Yes. It is because the seller charges ~~a~~ \neq different prices to different ~~of~~ consumers on the same good. And these can not be explain by the cost different. The pay TV channel offered discounts only to new subscribers, but not to the existing ones and this can't be explain by the price different.

15bii). Lower the quality ~~of~~ and lack of incentive for innovation. The seller may try to ~~improve~~ ~~it~~ improve the goods under the competition and may develop new products. If the competition policy introduce, the seller may have ~~to~~ low or even no incentive to take the above risk investment.

Efficiency loss.

The price discrimination bring MB close to MC in order to have a large profit. But if the competition policy, ~~MB~~ the total social surplus \otimes may not ~~#~~ be maximized and the inefficiency product can be protect as well.

Total: 54

Answers written in the margins will not be marked.

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