

## DSE ECON 2014 Marking Schemes

### Paper 1

Question No.	Key	Question No.	Key
1.	A (32)	26.	A (51)
2.	A (70)	27.	A (61)
3.	C (59)	28.	C (48)
4.	D (75)	29.	D (69)
5.	C (79)	30.	D (56)
6.	C (56)	31.	A (73)
7.	D (71)	32.	A (57)
8.	B (74)	33.	A (70)
9.	B (79)	34.	C (42)
10.	D (67)	35.	B (67)
11.	B (83)	36.	D (52)
12.	A (53)	37.	D (56)
13.	B (60)	38.	D (75)
14.	C (84)	39.	C (60)
15.	C (54)	40.	C (66)
16.	C (48)	41.	A (59)
17.	B (80)	42.	B (59)
18.	B (93)	43.	D (38)
19.	B (81)	44.	D (39)
20.	A (73)	45.	D (64)
21.	A (65)		
22.	B (72)		
23.	C (66)		
24.	C (73)		
25.	B (54)		

*Note: Figures in brackets indicate the percentages of candidates choosing the correct answers.*

These documents were prepared for markers' reference. They should not be regarded as sets of model answers. Candidates and teachers who were not involved in the marking process are advised to interpret their contents with care.

The answers provided in the marking scheme are for reference only. They are not the only possible answers. Alternative answers are acceptable so long as they are well reasoned.

The examination emphasises the testing of the understanding of economic theories and the application of the knowledge of economic analysis to practical problems. Candidates are advised to study this document in conjunction with the examiner's comments on candidates' performance in this booklet.

For essay-type questions, candidates are expected to demonstrate an understanding of the question, an ability to deploy relevant knowledge of the subject in response to the questions, and to present their answers logically and coherently.

In questions asking for a specified number of reasons or examples etc. and a candidate gives more than the required number, the extra answers should not be marked. For instance, in a question asking candidates to provide two examples, and if a candidate gives three answers, only the first two should be marked.

The following symbols are used:

- / A single slash indicates an acceptable alternative within an answer.
- @ The number in front of the symbol indicates the marks for each point.
- max Maximum mark for the question/sub-question

- |    |   | <b>Marks</b> |
|----|---|--------------|
| 1. | (a) Yes.<br>It is because the reduction in the starting salary of administrative officers would only decrease the value of Serine's chosen option without affecting her highest valued option forgone.  | (1)<br>(1)   |
|    | (b) No.<br>Government provision of unemployment benefits may increase the value of Serine's 3 <sup>rd</sup> option to a level higher than that of the 2 <sup>nd</sup> option. So the cost of choosing to work as an administrative officer may now change from the value of the 2 <sup>nd</sup> option (i.e., to work in an accounting firm as a trainee) to that of the 3 <sup>rd</sup> option (i.e., to continue to seek a job without taking up any job and simply enjoying the unemployment benefit). | (1)<br>(2)   |

- |    |   | <b>Marks</b> |
|----|---|--------------|
| 2. | (a) Entrepreneurship<br>as he bears business risk and makes business decisions.   | (1)<br>(1)   |
|    | (b) Cost of buying the accessories, or wages of part-time workers<br>as expenses on these items would vary (increase) with the output of Ah Wing's shop.<br>[Mark the FIRST example only.]                                      | (1)<br>(1)   |
|    | (c) Monopolistic competition<br>Reasons:<br>– many sellers / no dominant sellers<br>– sellers selling heterogeneous products<br>– free entry into the market<br>– any other relevant point<br>[Mark the FIRST TWO points only.] | (1)          |
- } @1  
max: 2

3. No.

Verbal elaboration:

The ineffective price floor ( $P_a$ ) becomes an effective price floor ( $P_b$ ).

At the new quantity (where the horizontal  $P_b$ -line intersects the demand curve  $D$ ), marginal benefit (maximum willingness-to-pay) is higher than marginal cost and there exists a deadweight loss.

Indicate on the diagram:

- Correct  $P_0$   $Q_0$
- Correct  $P_1$   $Q_1$
- Correct position of deadweight loss (DL)

Marks

- (1) }  
 (1) }  
 (1) }  
 (1) } max: 6  
 (1) }  
 (1) }  
 (1) }

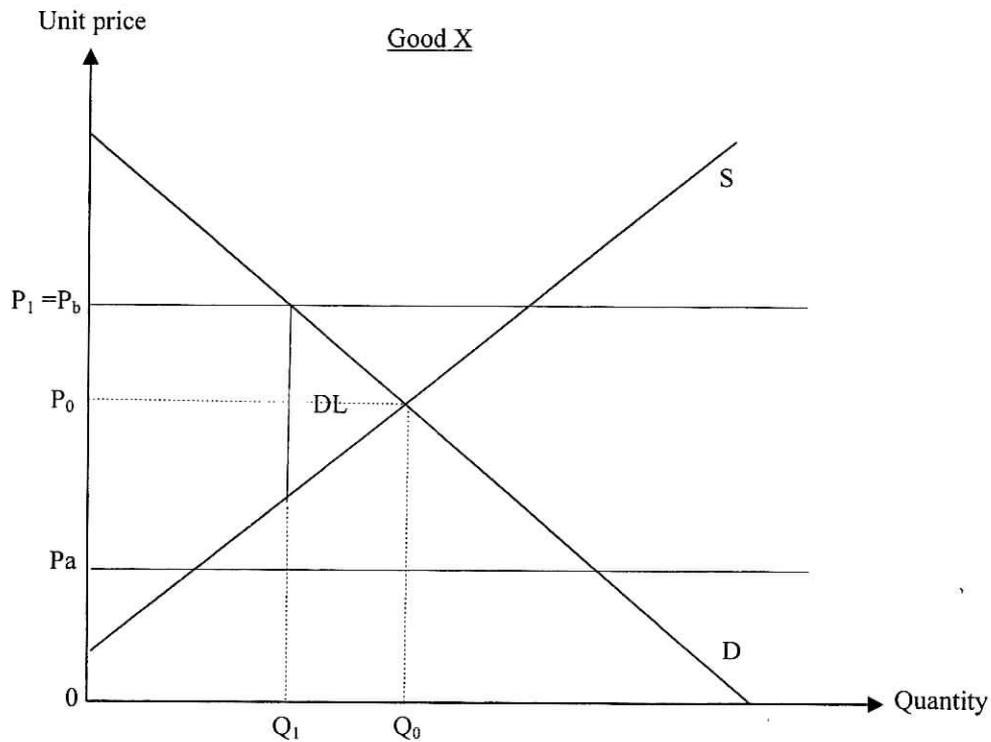


Figure 1

4. (a) Vertical backward expansion because, by starting Fai Lok Institute, Tai Fai Lok Group has expanded its operation vertically backward to the previous stage of production to control directly the supply of factor inputs (chefs and managers) to its original (food) business.

Marks  
(2)

(b) Advantages:

- More steady supply of factor inputs such as chefs and managers
- Better use of the brand name
- Program can be tailor-made for those graduates from the Institute who are hired to work in the Group's restaurant, so as to shorten their training time
- Any other relevant point

[Mark the FIRST TWO points only.]

} @2  
 max: 4

- Marks**
5. (a) The inflation rate in 2013:  $(126-120)/120 \times 100\% = 5\%$  (1)
- (b) Differences: } Any one;  
 - CPI only includes consumer goods while GDP deflator includes both consumer } max: 2  
 goods and producer goods.  
 - CPI calculates a fixed basket of goods and the weighting will be revised every 5 }  
 years while GDP deflator has variable baskets of goods for each year.  
 [Mark the FIRST point only.]
- (c) (i) Kitman would gain (1)  
 because the unexpected inflation would lower the real value (purchasing }  
 power) of the loan repayment. (1)
- (ii) Marlene would lose (1)  
 because, given the 15% rate of actual nominal return and the 5% rate of actual }  
 inflation, her actual real rate of return equals 10% (= 15% - 5%), which falls }  
 short of her expected real rate of return (12%). (2)

- Marks**
6. (a) No, (1)  
 because, according to the source principle, income not derived from HK would not }  
 be taxed by the HK government. (1)
- (b) Direct tax, (1)  
 because the tax burden cannot be shifted by these tax-payers to someone else. (1)

**Marks**

7. (a) Side effects of the contractionary fiscal policy:
- Negative output effect (fall in GDP) due to a reduction in government expenditure and thus aggregate demand
  - Negative output effect (fall in GDP) due to a rise in sales/income tax, which would lower consumption/investment demand and thus aggregate demand
  - Negative (disincentive) effect on labour supply and thus on employment (and output) as a result of higher income taxes
  - Any other relevant point
- [Mark the FIRST TWO points only.]

} @2;  
max: 4

- (b) Advantages:
- An increase in money supply would lower the interest rate and raise investment, leading to an increase in real output in the short run (given upward-sloping aggregate supply). Given idle resources in the economy, more labour (and/or capital) would be used to produce the bigger output, implying an increase in employment or decrease in unemployment. (Contractionary fiscal policy would not result in an increase in GDP and employment.)
  - Any other relevant point
- [Mark the FIRST point only.]

} @2;  
max: 2

- Disadvantages:
- In the long run (with vertical aggregate supply), an increase in money supply would not create any effect on output and employment. But if the fiscal deficits grow so fast that the money supply has to be increased at a higher rate than of real output, high inflation would even arise. (Contractionary fiscal policy would not result in inflation.)
  - Any other relevant point
- [Mark the FIRST point only.]

} @2;  
max: 2

**Marks**

8. (a) In Country A, the opportunity cost in producing 1 unit of watches (W) = 4 units of Paper (P).  
In Country B, the opportunity cost in producing 1 unit of watches (W) = 2 units of Paper(P).  
Country B will specialize in producing watches and export watches as the opportunity cost of producing watches is lower there than in Country A.
- (b) The terms of trade is  $1W=2.5P$ . Per unit of watches imported, Country A will gain  $1.5 P (= 4P - 2.5P)$ .

(3)

(3)

**Section B**

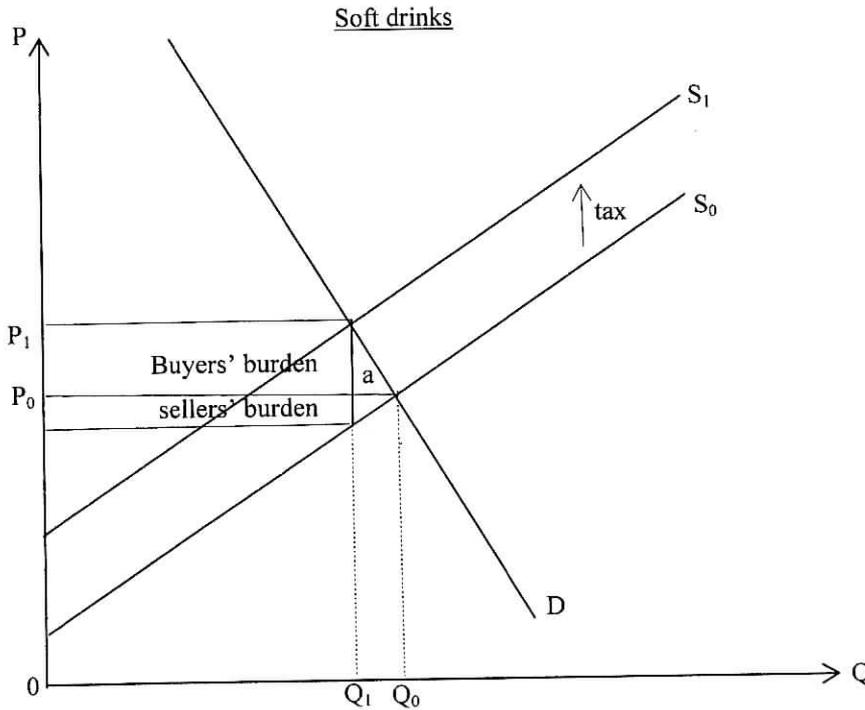
9. (a) The condition is that the elasticity of demand for the good is smaller than the elasticity of supply.

**Marks**  
(1)

Indicate on the diagram:

- Parallel upward shift of supply curve due to the per unit tax
- Price increases and quantity drops
- Correct positions of buyers' tax burden and sellers' tax burden
- Buyers' burden > sellers' burden

(1)  
(1)  
(1)  
(1)



- (b) Indicate on the diagram:  
reduction in consumer surplus : buyers' burden + area a

(1)

- (c) Law of demand: when the price of a good increases, the quantity demanded of the good decreases, vice versa, ceteris paribus. Here the unit of measurement to which the tax applies is "bottle," rather than volume (e.g., in litres), of soft drinks. When the same amount of tax is added to each unit (bottle), then -- per volume of liquid contained -- larger-bottle soft drinks would become cheaper than the small-bottle ones. The relative price of larger-bottle soft drinks (in terms of small-bottle ones) thus drops. The law of demand then implies that people would buy more larger-bottle soft drinks relative to small-bottle ones, so the proportion of larger-bottle soft drinks sold in the market would increase.

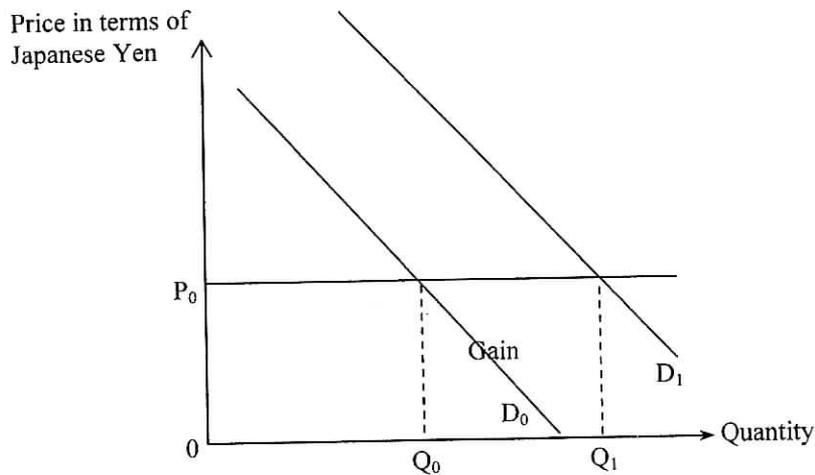
(5)

- |   | <b>Marks</b>             |
|---|--------------------------|
| 10 (a) (i) A declining birth rate implies a slower growth in the size of the work force and possibly a shrinking working population in the future. As fewer workers are there to pay taxes, future tax revenue may be reduced.  | (2)                      |
| (ii) A rising old-age dependency ratio implies higher percentage of the elderly in the population. The elderly may have lower (or even zero) income and greater needs for medical services. They may thus require more government support in terms of social welfare and public health, implying an increase in public expenditure on such programs.  | (2)                      |
| (b) Relaxation of one-child policy would likely result in a rise in the birth rate, implying a bigger work force and a bigger aggregate supply and output in the future   | (3)                      |
| (c) Public limited company / listed company.  | (1)                      |
| (d) (i) In a partnership, any given owner cannot transfer his/her shares of ownership without the consent of other partners while in a public limited company, the shares are freely transferable.  | (2)                      |
| (ii) A partnership does not have independent legal status while a public limited company has an independent legal status.   | (2)                      |
| (e) People expected the birth rate to rise, resulting in an expected increase in future demand for the baby products.<br>So Goodbaby International was expected to earn bigger profits<br>and to distribute more dividends per share to its shareholders in the future.<br>The expected increase in future dividends would raise the demand for the company's shares and thus its stock price as soon as people expect changes in the old-child policy. | (1)<br>(1)<br>(1)<br>(1) |

11. (a) Verbal elaboration:
- Japanese Yen depreciated against Hong Kong dollar. (1)
  - As the price of Japanese automobiles does not change, the automobiles become cheaper in terms of HKD and Hong Kong importers will buy more Japanese automobiles. (1)
  - The demand for Japanese automobiles by HK people increases. (1)
  - Quantity transacted increases. (1)
  - Therefore, total export value of Japanese automobiles increases.

Indicate on the diagram:

- Demand curve shifts to the right (1)
- A higher quantity transacted (1)
- Gain in total value (1)



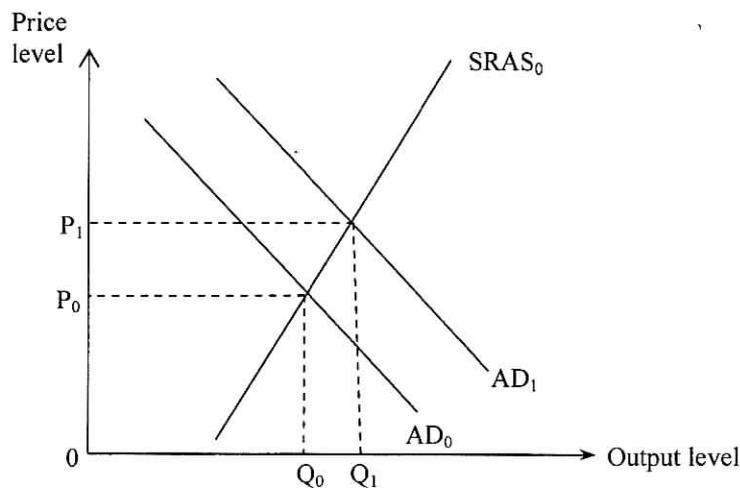
- (b) - Not all factor inputs used to produce Japanese cars originated from Japan. e.g., some of the parts or raw materials were imported (2)
- Some Japanese cars sold in 2013 were not produced in the same year. e.g., some of them came from the inventory (2)

[Mark the FIRST TWO reasons only.]

- |  | <b>Marks</b>                    |
|--|---------------------------------|
| 12. (a) Monetary base = cash in public circulation + reserves held by commercial banks<br>The monetary base increases because the commercial banks have more reserves.   | (1)<br>(2)                      |
| (b) Credit creation process:<br>When the central bank purchases bonds from commercial banks, more cash is injected to the commercial banks as reserves and there would be excess reserves in the banking system.<br>The banks would lend out the excess reserves.<br>And the bank loans will be re-deposited into the banking system.<br>The process will go on and on (until the actual reserves are equal to required reserves). | (1)<br>(1)<br>(1)<br>(1)        |
| No. The monetary base will remain unchanged as the sum of cash in public circulation and reserves in the banking system will not be affected by the credit creation process.   | (2)                             |
| (c) <u>Verbal elaboration:</u><br>The purchase of government bonds increases money supply resulting in a drop in the interest rate.<br>Investment / consumption expenditure increases and aggregate demand increases.<br>In the short run, the output and price levels increases.  | (1)<br>(1)<br>(1)<br>(1)<br>(1) |

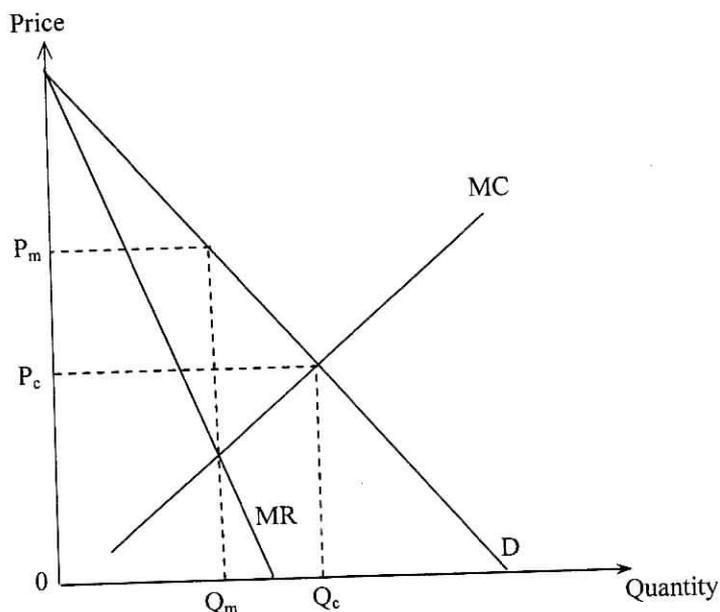
Indicate on the diagram:

- |                                |     |
|--------------------------------|-----|
| - AD curve shifts to the right | (1) |
| - Higher price level           | (1) |
| - Higher output                | (1) |



13. (a) Verbal elaboration:  
 The profit-maximizing output for a monopolist is determined by the equality between its marginal cost and marginal revenue. (1)

- Indicate on the diagram:  
 - Correct marginal revenue curve (1)  
 - Correct  $Q_m$  and  $P_m$  (1)



- (b) Verbal elaboration:  
 Under perfect competition, output is determined by the equality between marginal cost and marginal willingness-to-pay. (1)  
 The opening of the market will result in a drop in price (1)  
 and a rise in quantity. (1)

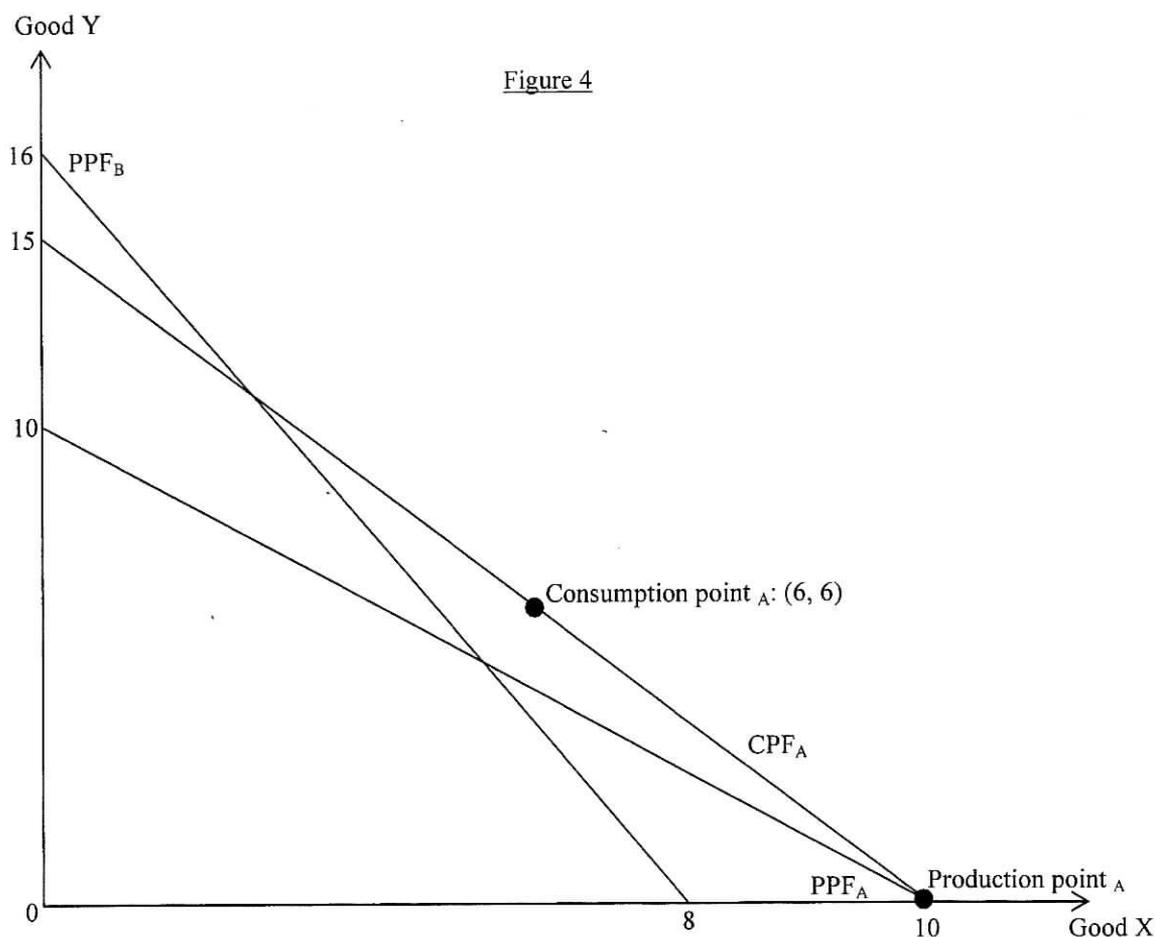
- Indicate on the diagram:  
 - Correct  $Q_c$  and  $P_c$  (1)

- (c) No, as all consumers are entitled to the same discounts (pricing practice) and there is no market segmentation. (3) } Either one, max: 3  
**OR**  
 Yes, as consumers buying different quantities ("pounds") of beef would end up paying different "average prices" (price per pound) for the same beef produced at the same cost.

- (d) (i) Exclusive dealing. It forecloses third-party access to its distribution network. (2)  
 (ii) Price fixing. Through such collusive action, they can drive the small retailers out of the market. (2)

- (e) - Introducing more sellers may improve efficiency via competition } @2  
 - Consumers can enjoy lower price and higher quantity and quality of live cattle products } max: 2  
 - Any other relevant point  
 [Mark the FIRST point only.]

14. (a) The marginal (and average) costs of production for Good X and Good Y are constant (and do not increase with the quantities of X or Y). So the opportunity cost of X in terms of Y, which is the slope of the PPF, is constant. (2)
- (b) (i) Country B can produce 8 units of Good X by using all of its resources. Given the amount of resources owned by Country A doubles that of Country B, Country A can only produce 5 (= 10/2) units of X by using the same amount of resources as B. So Country A does not have absolute advantage in producing X. (3)
- (ii) In Country A, the opportunity cost of producing one unit of X is  $(10/10) = 1Y$ . In Country B, the opportunity cost of producing one unit of X is  $(16/8) = 2Y$ . So Country A has comparative advantage in producing Good X. (2)
- (c) Indicate on the diagram:
- (i) production point of Country A: (10,0) (1)
- (ii) CPF of Country A: a straight line with X-intercept equals 10 and Y-intercept equals 15 (2)
- (iii) consumption point of Country A: (6, 6) (2)



- (d) Policies:
- tax allowance for further education (or education subsidy)
  - teaching grants -- to universities for more degree programmes
  - bigger immigration quota for experts and professionals
  - any other relevant point
- [Mark the FIRST TWO points only.]
- } @2  
max: 4