

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.

There are 45 questions in this paper. Choose the **BEST** answer for each question.

1. The operator of a canteen in the government headquarters decides to sell sushi and not burgers anymore because the former can earn a higher profit. This is an example of using _____ to solve the problem of _____.
 - A. government command 'what to produce'
 - B. government command 'for whom to produce'
 - C. market mechanism 'what to produce'
 - D. market mechanism 'for whom to produce'

2. Which of the following statements about interest is correct?
 - A. Without money, interest does not exist.
 - B. Without inflation, interest does not exist.
 - C. Without scarcity, interest does not exist.
 - D. Interest is the compensation paid to the borrower for delayed consumption.

3. A public good
 - A. is a good with zero marginal cost of production.
 - B. can only be provided by the government.
 - C. cannot be protected by private property rights.
 - D. allows concurrent consumption by many individuals.

4. Which of the following would be the loss(es) of delaying the completion of a new railway to an economy?
 - (1) the travel time of passengers that would have been saved by the new railway during the period of delay
 - (2) the damage to the corporate image of the railway constructor for the delay
 - (3) the nuisance to the shops and residents nearby during the period of delay
 - A. (1) only
 - B. (2) only
 - C. (3) only
 - D. (1), (2) and (3)

5. Alan and his partners turned their partnership into a private limited company. After the change, the firm will
 - A. have more capital for development.
 - B. have a lower average production cost.
 - C. enjoy a lower profits tax rate.
 - D. have a separate legal entity.

6. The government launched the Silver Bond for Hong Kong residents aged 65 or above. Bondholders will be paid interest at a rate linked to inflation in Hong Kong, subject to a minimum rate of 2% per year. Bondholders may sell their bonds at original price to the government before maturity.

Which of the following statements about the Silver Bond is/are correct?

- (1) The risk of holding the Silver Bond is lower than that of the shares of a listed company.
(2) The return of the Silver Bond would increase during inflation while the return of the shares of a listed company would not.
(3) The interest received by Silver Bond holders is higher than the dividend received by the shareholders of a listed company.
- A. (1) only
B. (2) only
C. (3) only
D. (1), (2) and (3)
7. Certain restaurants in China found that they can introduce robots to replace some workers in serving customers without reducing their output. This will
- A. increase the quantity supplied of restaurant workers.
B. increase the labour productivity of those restaurants.
C. decrease the geographical mobility of restaurant workers.
D. decrease the occupational mobility of restaurant workers.

8. The following table shows the cost-output relationship of a price-taker.

Output (units)	Average cost (\$)
5	10
6	11
7	12
8	13
9	14

The market price is \$20. Suppose the average cost has increased by \$2 for every unit of output. The profit of the firm will _____.

- A. increase by \$16
B. increase by \$14
C. decrease by \$16
D. decrease by \$14
9. Giordano International Limited is a retailer of casual wear. It has launched the Giordano Ladies, which provides luxury clothes and suits for ladies. It is an example of _____ expansion.
- A. horizontal
B. vertical
C. lateral
D. conglomerate

10. An art centre extends its business hours for one hour in order to offer more painting classes. Which of the following are variable costs involved in the extra hour of operation?

- (1) salary of the accountant
 - (2) electricity fee
 - (3) expense on paints
 - (4) rental payment
- A. (1) and (4) only
 - B. (2) and (3) only
 - C. (1), (2) and (4) only
 - D. (1), (2), (3) and (4)

11. The input-output relationship of a firm is as follows:

	Year 1	Year 2
Number of workers	30	35
Number of working hours per worker per day	10	8
Quantity of output (units)	3 000	2 900

Based on the above information, labour supply _____ and average labour productivity _____.

- A. rises rises
- B. rises falls
- C. falls rises
- D. falls falls

12. A famous artist, Tsz-Wah, held a show. Many people complained that they could not buy a ticket. Ticket touts resold the tickets on the Internet and some buyers paid a price higher than HK\$10 000 for a ticket.

The above case illustrates the _____ function of price because _____.

- A. rationing the tickets are rationed to the highest-valued buyers
- B. rationing demand will be reduced by a higher price
- C. allocative more profits can be earned with a higher price
- D. allocative more resources should be allocated to the producer to raise the supply

13. Which of the following is **INCONSISTENT** with the law of demand?

- A. The abolishment of per unit import tariff on garment results in a rise in the quality of imported garments.
- B. Live fishes sold in a market near the fish farm have a higher price than frozen fishes sold in a faraway market.
- C. The ratio of high-quality white wine sold to total white wine sold remains unchanged when the government imposes an ad valorem tax on white wine.
- D. Developers tend to build higher-quality housing units on a piece of land with a good view.

14. Which of the following situations would most likely lead to an increase in the demand for iPhone produced by Apple Inc.?
- A. A technological breakthrough in the battery industry reduces its production cost.
 - B. People expect the next model of iPhone will have more innovative features.
 - C. A model of Samsung smartphone is banned by many airlines.
 - D. Apple Inc. reduces the selling price of iPhone.

15. Refer to the following conversation between Mandy and Shirley.

Mandy:	I like coffee very much! No matter how its price changes, I always buy the same amount of coffee every week!
Shirley:	I like coffee very much too! No matter how its price changes, I always spend the same amount of money on coffee every week!

Based on their conversation, Mandy's demand for coffee is _____ and Shirley's demand for coffee is _____.

- A. perfectly inelastic perfectly inelastic
 - B. perfectly inelastic unitarily elastic
 - C. unitarily elastic perfectly inelastic
 - D. unitarily elastic unitarily elastic
16. Refer to the following supply and demand schedules for Good X.

Unit price (\$)	6	7	8	9	10	11	12	13
Quantity demanded	140	130	120	110	100	90	80	70
Quantity supplied	60	70	80	90	100	110	120	130

If the government imposed a \$2 per unit tax on Good X,

- A. sellers' revenue net of tax would become \$990.
 - B. tax burden borne by the sellers would be \$90.
 - C. the total tax revenue would be \$200.
 - D. buyers' total expenditure on Good X would decrease by \$40.
17. Suppose Good Y is an inferior good. When people's income rises and the production cost of Good Y increases, the equilibrium price of Good Y _____.
- A. will increase
 - B. will decrease
 - C. will remain unchanged
 - D. may increase or decrease
18. Suppose the government imposed an effective rent control on living units. Which of the following would **LEAST** likely occur?
- A. There would be a shortage of living units.
 - B. Black market would emerge.
 - C. Poor people would be able to rent a living unit more easily.
 - D. Landlords would have a lower incentive to renovate their living units for rent.

19. Which of the following statements about monopolistic competition are correct?

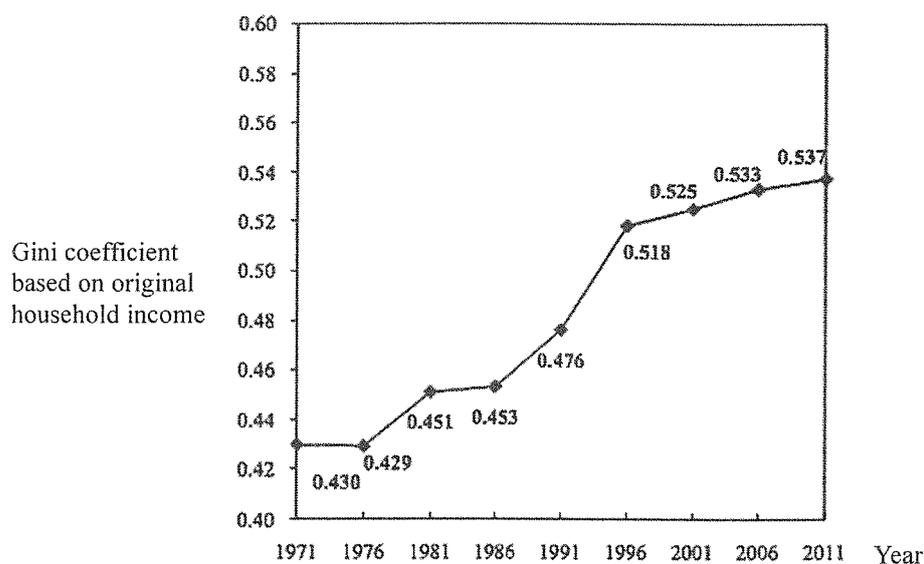
- (1) There can be a few or many buyers and sellers in the market.
- (2) The sellers are price searchers.
- (3) The goods and services provided by the sellers are homogeneous.
- (4) There are free entry and exit in the market.

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

20. Li Ka Shing Foundation gave HK\$5 000 to each 2017 HKDSE candidate living in those remote districts with lower average household income. Which of the following statements about this unconditional gift is correct?

- A. It reduces the income inequality as a larger portion of the receivers of the gift are from lower income group.
- B. It increases the income inequality as it is unfair to the candidates living in the non-remote districts.
- C. As the money is given to all candidates living in those remote districts, income distribution remains unchanged.
- D. It helps equalising opportunities as those candidates will study harder to improve their exam results.

21. The following diagram shows the Gini coefficient of Hong Kong based on original household income.



Based on the above diagram, we can conclude that

- A. the income level of Hong Kong people increased.
- B. income for high income household increased while income for low income household decreased.
- C. the welfare policy failed to reduce the income inequality.
- D. income gap had been widening.

22. The Work Incentive Transport Subsidy Scheme helps low-income earners reduce their cost of travelling to and from work and encourages them to get a job. Workers meeting certain criteria, such as monthly income and asset limits, are eligible to get the subsidy.

Which of the following would likely occur after the implementation of this scheme?

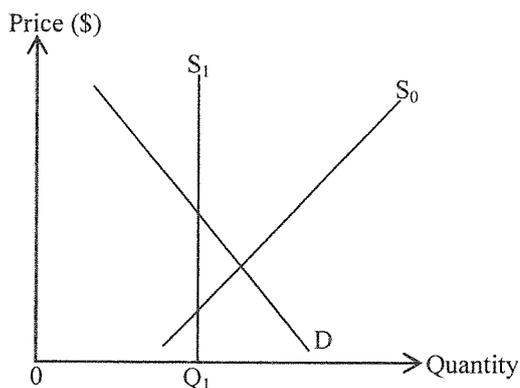
- (1) Labour supply would increase.
- (2) Labour productivity would increase.
- (3) Geographical mobility of labour would increase.
- (4) Income inequality would decrease.

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

23. If the government raises the effective price floor on Good X and at the same time the price of its substitute increases, the consumer surplus in the market of Good X _____.

- A. will increase
- B. will decrease
- C. will remain unchanged
- D. may increase or decrease

24. Refer to the following supply-demand diagram of a good with a quota set at Q_1 by the government.

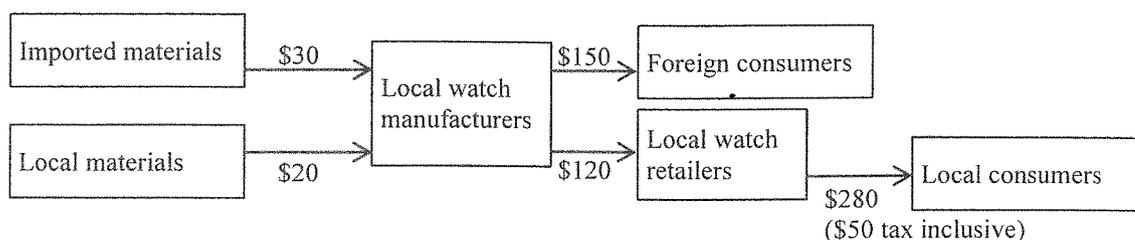


Which of the following will be the results of a reduction in quota on the good?

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

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

25. The following diagram shows a production chain of watches in an economy:



The contribution of the local watch manufacturers to the economy's GDP at market prices is _____.

- A. \$220
- B. \$240
- C. \$350
- D. \$400

26. The following table shows some data of an economy.

	Growth rate	
	2015	2016
GDP	-3%	-2%
Price level	1%	0%
Population	4%	2%

Which of the following statements about the economy is correct?

- A. Real GDP in 2016 decreases.
- B. Per capita GDP in 2016 increases.
- C. The price level in 2016 decreases.
- D. The growth rate of real GDP in 2016 is lower than that in 2015.

27.

The government launches 'Admission Scheme for the Second Generation of Chinese Hong Kong Permanent Residents' (輸入中國籍香港永久性居民第二代計劃) in order to meet the challenge of ageing population and declining workforce.

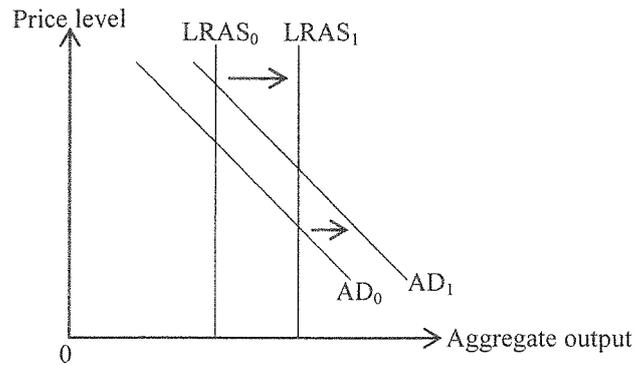
If some second-generation of Hong Kong permanent residents returned to Hong Kong to fill up the posts which have been vacant for a long time, Hong Kong's labour force would _____ and the unemployment rate would _____.

- A. rise remain unchanged
- B. rise fall
- C. fall remain unchanged
- D. fall fall

28. The aggregate demand curve of Hong Kong will shift to the left if

- A. the implicit GDP deflator rises continuously.
- B. the government raises the retirement age of all civil servants.
- C. the number of tourists from the Mainland decreases.
- D. the Mainland stock market booms.

29.



The diagram above shows the aggregate demand curves and long run aggregate supply curves of an economy. Which of the following best explains the above changes?

- A. a decrease in people's desire to save
- B. an enhancement in production technology
- C. an increase in national income of the economy's trading partners
- D. an increase in government subsidy on private research and development

30. Electronic payment systems allow customers to pay without cash. ApplePay, Visa payWave and MasterCard paypass are some of the examples.



When more shops accept these electronic payment systems as a method of payment,

- (1) their cost of handling coins and notes will fall.
- (2) the actual banking multiplier may increase.
- (3) transactions demand for money will increase.

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

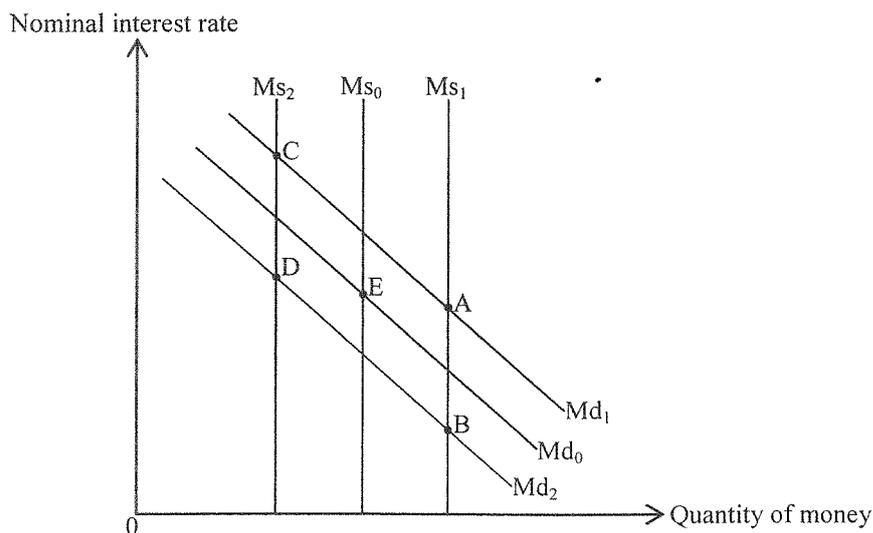
31. The following table shows the balance sheet of a banking system.

Assets (\$)		Liabilities (\$)	
Reserves	300	Deposits	900
Loans	600		

Suppose the public does not hold cash and the required reserve ratio is reduced to 25%. After deposit creation, the amount of loans in the banking system is \$750. Which of the following statements about the banking system is correct?

- A. The money supply increases by \$300.
- B. The actual banking multiplier is 3.5.
- C. The deposits increase by \$600.
- D. Bank reserves are \$450.

32. The diagram below shows the money demand and supply curves of an economy. The original equilibrium point is at E.



Suppose the risk of holding interest bearing assets (such as bonds) increases and the central bank reduces the discount rate. The new equilibrium point will be at _____.

- A. A
- B. B
- C. C
- D. D

33. Refer to the following data about Hong Kong's money supply.

Components	\$ billion
Total issue of legal tender	300
Legal tender held by all authorised institutions	80
Demand deposits	100
All types of deposits with licensed banks and negotiable certificates of deposit issued by licensed banks (other than those held by authorised institutions)	3 000

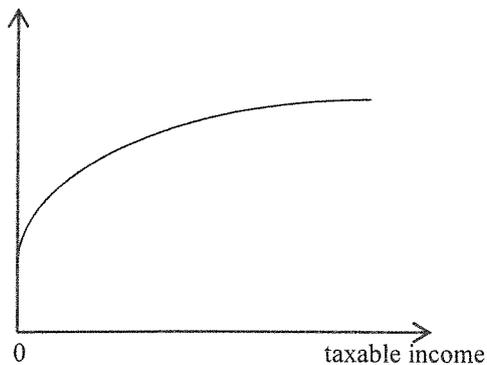
The money supply M2 is _____.

- A. \$320 billion
- B. \$3 180 billion
- C. \$3 220 billion
- D. \$3 300 billion

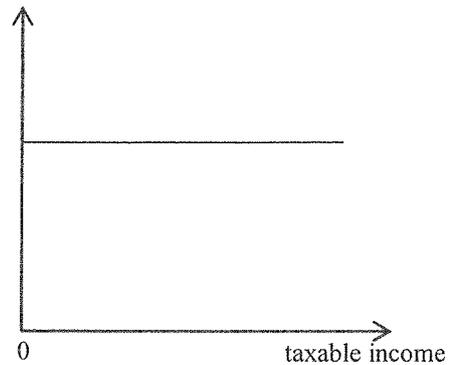
34. When there is unexpected inflation, which of the following individual(s) will lose?
- A. A firm owner paying his workers a fixed wage
 - B. A flat owner charging a rental with adjustment according to the change in price level
 - C. A retired civil servant receiving a fixed monthly pension
 - D. All of the above individuals will lose because the purchasing power of money will be lower.

35. Which of the following diagrams describe a regressive tax?

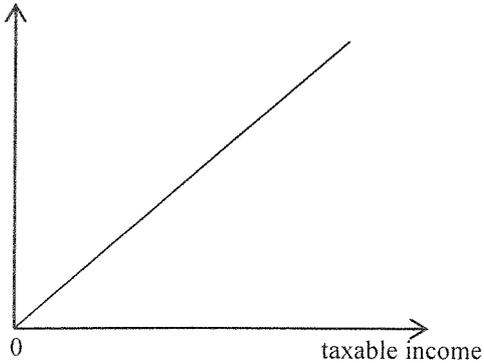
(1) tax payment (\$)



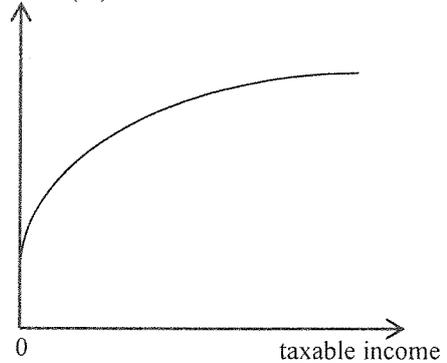
(2) tax payment (\$)



(3) tax rate (%)



(4) tax rate (%)



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

36. According to the quantity theory of money, if a central bank increases money supply,

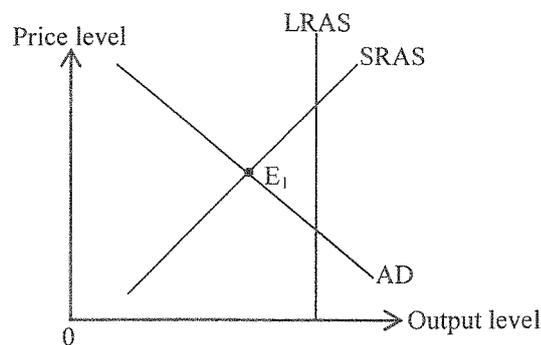
- A. the price level will increase.
- B. real output will remain constant.
- C. nominal output will increase.
- D. the unemployment rate will decrease.

37. Which of the following policies would most likely lead to a drop in aggregate output?
- The government bought bonds from the public and raised the tax allowance at the same time.
 - The government sold bonds to the public and reduced transfer payment to the poor at the same time.
 - The government reduced required reserve ratio and raised the progressivity of income tax at the same time.
 - The government increased the discount rate and lowered profits tax rate at the same time.

38. To reduce fiscal deficits, the government may adopt either contractionary fiscal policy (e.g. increase taxes and/or decrease fiscal spending) or expansionary monetary policy (e.g. finance the deficits by printing money).

Refer to a situation of an upward-sloping short run aggregate supply curve. Which of the following are the advantages of using expansionary monetary policy over contractionary fiscal policy to reduce fiscal deficits?

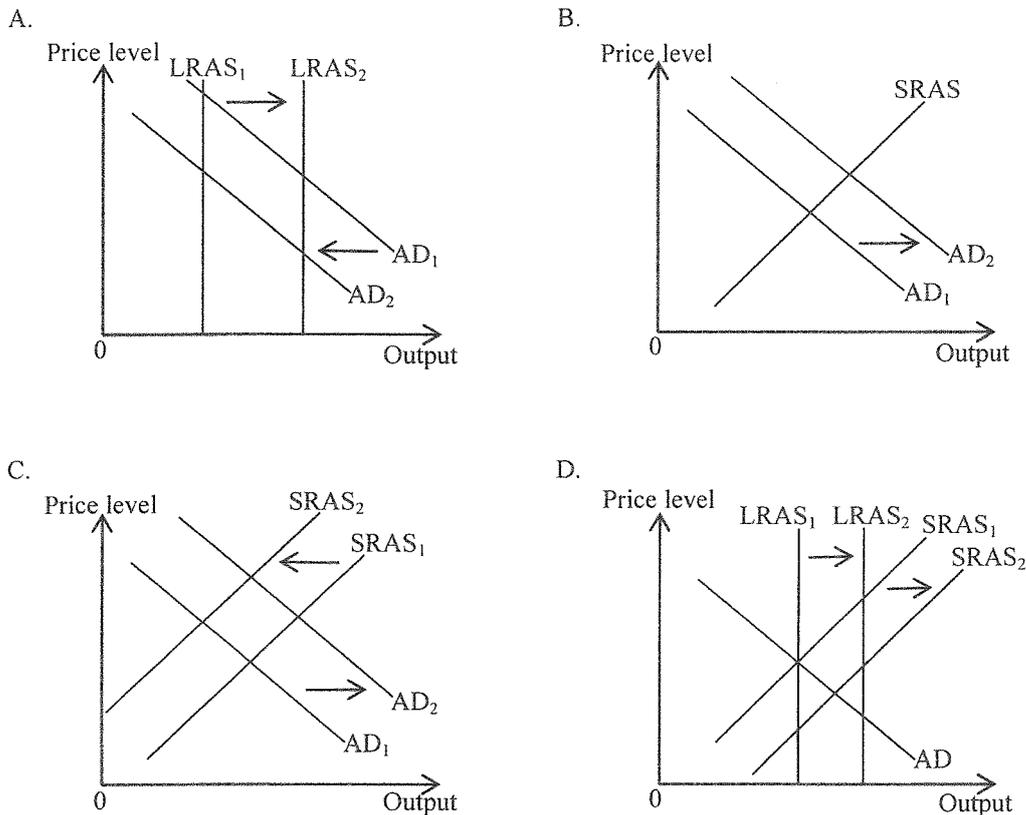
- The employment level will be higher.
 - The purchasing power of money will be higher.
 - The real output level will be higher.
- (1) and (2) only
 - (1) and (3) only
 - (2) and (3) only
 - (1), (2) and (3)
39. The diagram below shows the aggregate demand curve, the short run aggregate supply curve and the long run aggregate supply curve of an economy.



Suppose the economy initially operates at E_1 and the total import value equals total export value. If the government decreases the social security assistance to the elderly, in short run, the deflationary (output) gap will be _____ and there will be a _____.

- narrower trade surplus
- wider trade deficit
- narrower trade deficit
- wider trade surplus

40. In his 2016-17 Budget, the Financial Secretary proposed to waive business registration fees for 2016-17. At the same time, the personal basic tax allowance was raised from \$120 000 to \$132 000. Which of the following best illustrates the effect of the above changes on the price and output levels?



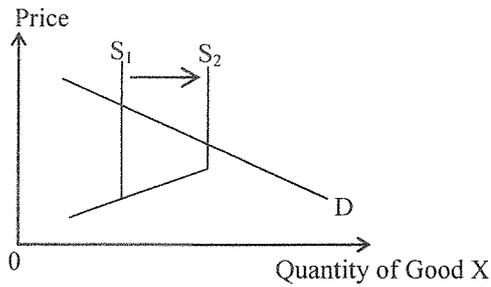
41. Which of the following transactions will be included in the calculation of the balance of payments of Hong Kong?

- (1) A Mainland resident who owns an apartment in Hong Kong receives rental payment from his tenant.
- (2) A Japanese resident sells the shares of a Hong Kong firm to a Korean resident.
- (3) A Hong Kong resident buys an air ticket to London from a Hong Kong based airline.
- (4) An Indonesian who works in Hong Kong as a domestic helper remits money to her husband who lives in Indonesia.

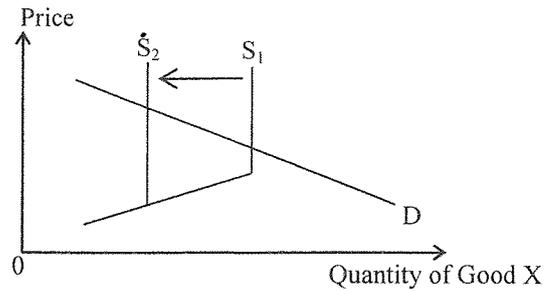
- A. (1) and (3) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (2) and (4) only

42. A small open economy increases the import quota for Good X. Which of the following diagrams best illustrates the effect of this change?

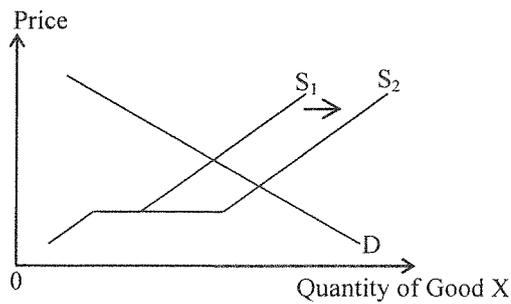
A.



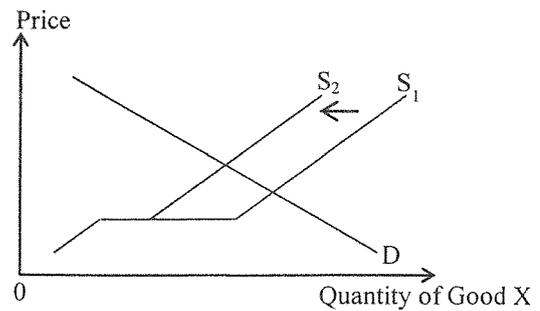
B.



C.



D.



43. The following table shows the number of man-hours required by Country A and Country B in the production of toys and watches.

	1 unit of toys	1 unit of watches
Country A	4	8
Country B	5	20

Suppose the transportation cost for 1 unit of toys is 0.1 units of watches and it is borne by the exporting country. Which of the following would be a mutually beneficial terms of trade between Country A and Country B?

- A. 1 unit of toys = 0.3 units of watches
- B. 1 unit of toys = 0.4 units of watches
- C. 1 unit of toys = 2.5 units of watches
- D. 1 unit of toys = 6 units of watches

44.

Date	Exchange rates
22 November 2015	US\$1 = RMB¥6.39
22 November 2016	US\$1 = RMB¥6.89

The above change in the exchange rate between the US Dollar and the Renminbi would lead to

- (1) a decrease in the number of Chinese tourists to the US.
- (2) a decrease in the competitiveness of US exports to China.
- (3) an increase in the total value of US exports to China (in terms of the US Dollar).

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

45. Under the linked exchange rate system of Hong Kong, which of the following statements is correct?

- A. The non-bank public can sell their Hong Kong dollars to the Hong Kong Monetary Authority in exchange for US dollars at any time.
- B. It enables the Hong Kong Monetary Authority to carry out an expansionary monetary policy to stimulate private investment.
- C. The market exchange rate of the US Dollar against the HK Dollar is fixed at US\$1 = HK\$7.8.
- D. There would be a downward pressure on the consumer price indices of Hong Kong when the Renminbi continuously depreciates against the US Dollar.

END OF PAPER

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