

2014

MC Answers.

1-5 A A C D C

6-10 C D B B D

11-15 B A B C C

16-20 C B B B A

21-25 A B C C B

26-30 A A C D D

31-35 A A A C B

36-40 D D D C C

41-45 A B D D D

# CONFIDENTIAL (FOR MARKERS' USE ONLY)

- |    |  | Marks |
|----|--|-------|
| 1. | (a) Yes.   | (1)   |
|    | It is because the drop in salary of the administrative officer only decreases the value of the chosen option, but it does not affect the highest valued option forgone.  | (1)   |
|    | (b) No.  | (1)   |
|    | As the value of the third preference increases as a result of more income granted by the government, it is possible that the value of the third option is higher than that of the second option. So the cost of choosing to work as an administrative officer may change from 'to work in an accounting firm as a trainee' to 'continue seeking a job without taking up any job and enjoy the unemployment benefit'. | (2)   |
|    |  |       |
|    |  | Marks |
| 2. | (a) Entrepreneurship   | (1)   |
|    | as he bears business risk and makes business decisions.  | (1)   |
|    | (b) The cost of buying the accessories/wage of part-time workers   | (1)   |
|    | as the expense on these items will increase with the output of Ah Wing's shop.<br>[Mark the FIRST example only.]   | (1)   |
|    | (c) Monopolistic competition   | (1)   |
|    | Reasons:   |       |
|    | - many sellers/no dominant sellers   |       |
|    | - sellers selling heterogeneous goods  |       |
|    | - free to enter the market   |       |
|    | - Any other relevant point   |       |
|    | [Mark the FIRST TWO points only.]  |       |

} @1  
max: 2

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3. No.

Verbal elaboration:

The ineffective price floor becomes an effective price floor.  
At the new quantity, marginal benefit 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)

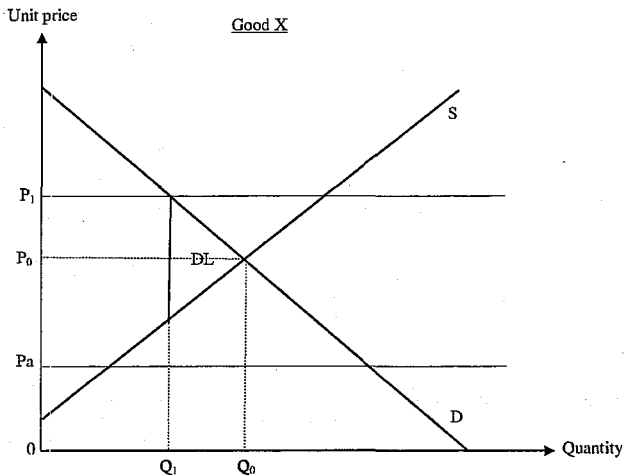


Figure 1

4. (a) Vertical backward expansion.

It is because it expands to a business which involves the previous stage of production / provides factor inputs to the original business.

Marks

(1)

(1)

(b) Advantages:

- More steady supply of factor inputs such as chefs and managers
- Better use of the brand name
- Tailored program can be designed so that less training time is required for the institute graduates
- Any other relevant point

[Mark the FIRST TWO points only.]

@2

max: 4

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5. (a) The inflation rate in 2013:  $(126-120)/120 \times 100\% = 5\%$  Marks  
(1)
- (b) Differences:
- CPI only includes consumer goods while GDP deflators include both consumer 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.] } Any one;  
max: 2
- (c) (i) Kitman would gain (1)  
because the unexpected inflation would lower the purchasing power of the loan repayment. (1)
- (ii) Marlene would lose (1)  
because the expected real rate of return was 12% while the unexpected inflation would make the actual real rate of return equal  $15\% - 5\% = 10\%$  only. (1)
6. (a) No, Marks  
(1)  
as according to the source principle, the income is not taxable as it is not derived from Hong Kong. (1)
- (b) Direct tax, (1)  
as the tax burden of salaries tax cannot be shifted to others. (1)

## CONFIDENTIAL (FOR MARKERS' USE ONLY)

7. (a) Side effects of the contractionary fiscal policy:
- increase unemployment level as firms may move away from US after the rise in tax
  - reduce GDP as government expenditure drops
  - disincentive effect on labour as a result of higher salaries tax
  - Any other relevant point
- [Mark the FIRST TWO points only.]
- (b) Advantages:
- Given the economy has idle resources, the increase in money supply will lower the interest rate and raise investment leading to an increase in real output. The increase in aggregate output may result in an increase in employment and reduce unemployment level (while the contractionary fiscal policy will not result in an increase in GDP and employment).
  - Any other relevant point
- [Mark the FIRST point only.]
- Disadvantages:
- If the money supply increases sharply (with a growth rate higher than that of real output), in the long run there will be high inflation (while the contractionary fiscal policy will not result in an increase in inflation).
  - Any other relevant point
- [Mark the FIRST point only.]
- Marks
- } @2;  
max: 4
- } @2;  
max: 2
- } @2;  
max: 2

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.
- (b) The terms of trade is  $1W=2.5P$ . Per unit of watches imported, Country A will gain  $(4-2.5) = 1.5 P$ .
- Marks
- (3)
- (3)

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## 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:

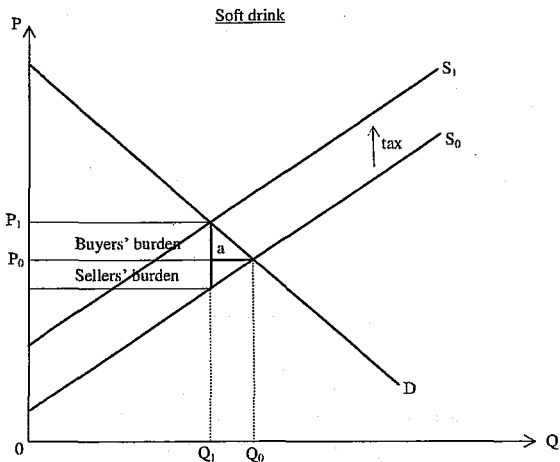
- Parallel upward shift of supply curve due to the per unit tax
- New P and Q
- Correct position of buyers' and sellers' tax burden
- Buyers' burden > sellers' burden

(1)

(1)

(1)

(1)



- (b) Indicate on the diagram:  
reduction in consumer surplus : buyer's 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.

(2)

When the same per unit tax is added to each bottle of soft drinks, the large-bottle soft drinks becomes relatively cheaper than the small-bottle ones. The relative price of large-bottle soft drinks (in terms of small-bottle ones) drops. People will buy more larger-bottle soft drinks relative to small-bottle ones so the proportion of larger-bottle soft drinks will increase.

(3)

## CONFIDENTIAL (FOR MARKERS' USE ONLY)

- |   | Marks                    |
|---|--------------------------|
| 10 (a) (i) A decreasing birth rate implies a smaller work force in the future. As a majority of tax revenue is generated from the work force, the shrinking work force may result in lower tax revenue.   | (2)                      |
| (ii) An increasing old-dependency ratio implies a higher percentage of the elderly. The elderly may have lower income and in greater needs of medical services in general and may require more government support in terms of welfare and public health, so the increase in the portion of the elderly may result in an increase in public expenditure on welfare and health. | (2)                      |
| (b) Relaxation of one-child policy may result in an increase in birth rate.<br>So the future work force will increase<br>and the long run aggregate supply increases.   | (1)<br>(1)<br>(1)        |
| (c) Public limited company/listed company.  | (1)                      |
| (d) (i) In a partnership the owners cannot transfer their 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 was expected to be more profitable<br>and holding its shares <i>might receive more dividends in the future.</i><br>So the expected increase in dividends would increase the present demand for the shares.                               | (1)<br>(1)<br>(1)<br>(1) |

## CONFIDENTIAL (FOR MARKERS' USE ONLY)

Marks

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. (1)

The demand for exported Japanese automobiles increases. (1)

Quantity transacted increases. (1)

Therefore, total value of exported Japanese automobiles increases.

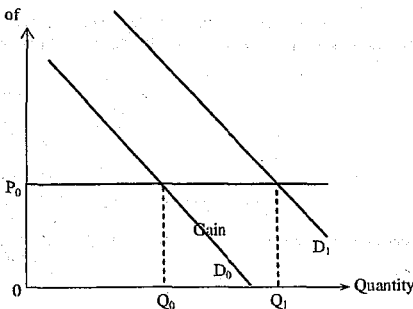
Indicate on the diagram:

- Demand curve shifts to the right (1)

- A higher quantity transacted (1)

- Gain in total value (1)

Price in terms of  
Japanese Yen



(b) - Part of it is not locally produced. (1)

e.g. some of the production raw materials are imported (1)

- Part of it is not produced in the current year. (1)

e.g. some of the goods come from the inventory (1)

[Mark the FIRST TWO reasons only.] (1)

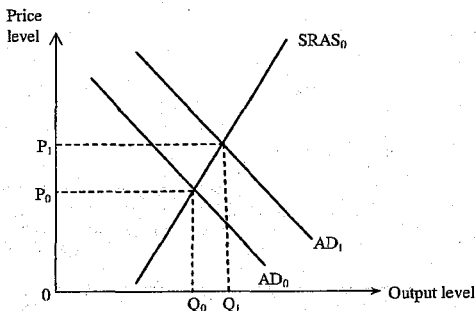


## CONFIDENTIAL (FOR MARKERS' USE ONLY)

- |  | Marks                           |
|--|---------------------------------|
| 12. (a) The monetary base increases.<br>Monetary base = cash in public circulation + reserves held by commercial banks<br>It is because the commercial banks have more reserves.   | (1)<br>(1)<br>(1)               |
| (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 are excess reserves in the banking system.<br>The banks would lead 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 is equal to required reserves). | (1)<br>(1)<br>(1)<br>(1)        |
| The monetary base will remain unchanged as the cash 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 interest rate.<br>Investment/ consumption/ aggregate demand increases.<br>In the short run, the price level increases while output level also 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) |



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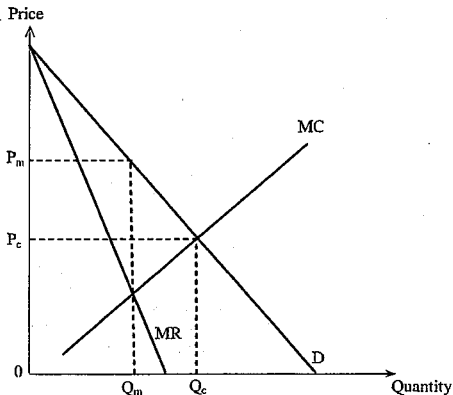
## Section C

Marks

13. (a) Verbal elaboration:  
 The profit maximizing condition for a monopolist is that marginal cost equals marginal revenue. (1)

Indicate on the diagram:

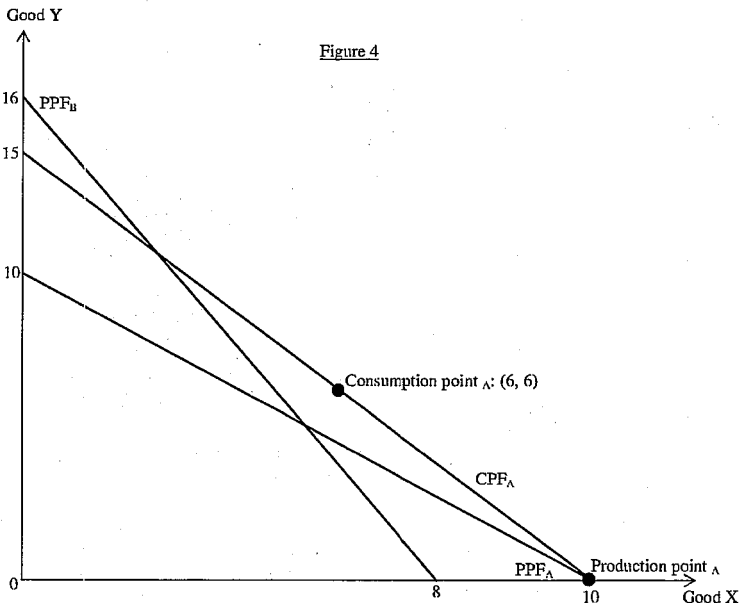
- Correct marginal revenue curve (1)
- Correct  $Q_m$  and  $P_m$  (1)



- (b) Verbal elaboration:  
 The output will be determined by the condition of marginal cost equals marginal willingness to pay. (1)  
 The opening of the market will result in a drop in price (1)  
 and a rise in quantity. (1) } max: 4
- Indicate on the diagram:  
 - Correct  $Q_c$  (1)  
 - Correct  $P_c$  (1)
- (c) Yes as consumers buying different quantity of beef will end up paying different price on average for the same good produced at the same cost. (3)  
**OR**  
 No as all the consumers are facing the same pricing practices and markets are not separated. } Either one, max: 3
- (d) (i) Exclusive dealing. It forecloses third-party access to distribution network. (2)  
 (ii) Price fixing. They drive out the small retailers from the market. (2)
- (e) - Introducing more sellers may improve efficiency  
 - Consumers can enjoy lower price and higher quality of live cattle products  
 - Any other relevant point } @2 max: 2  
 [Mark the FIRST point only.]

## CONFIDENTIAL (FOR MARKERS' USE ONLY)

- |   | Marks |
|---|-------|
| 14. (a) The cost of production for Good X and Good Y are constant, i.e. the cost does not increase with the quantity 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 produces 8 units of X when using all resources on X. If Country A spends half of the resources on X, it will produce 5 units of X. Given the amount of resources of Country A doubles that of Country B, Country A produce less X with the same amount of resources. So Country A does not have the absolute advantage in producing Good 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 a comparative advantage in producing Good X.   | (2)   |
| (c) <u>Indicate on the diagram:</u>   |       |
| (i) production point of Country A (10,0)  | (1)   |
| (ii) CPF of Country A: a line from (10,0) to (0,15)   | (2)   |
| (iii) consumption point of Country A: (6, 6)  | (2)   |



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