

**HONG KONG DIPLOMA OF SECONDARY
EDUCATION EXAMINATION MOCK PAPER**

ECONOMICS
PAPER 1: MULTIPLE CHOICE

Time Allowed: 1 hr

Total Marks: 45

INSTRUCTIONS TO CANDIDATES:

1. This paper consists of multiple sections.
2. Answer ALL questions in this paper.
3. Write your answers in the spaces provided.
4. Unless otherwise specified, all working must be clearly shown.
5. Unless otherwise specified, numerical answers should be either exact or correct to 3 significant figures.

SECTION A

QUESTION 1

A student spends an afternoon either working part-time or revising for an examination. The opportunity cost of revising is (1 mark)

- A. the money spent on revision materials only.
- B. the value of the best alternative forgone, including the earnings from work.
- C. the value of all alternatives forgone.
- D. zero, because the student does not pay tuition fees.

QUESTION 2

Which statement best illustrates the economic problem of scarcity? (1 mark)

- A. A resource has alternative uses while wants exceed the resources available to satisfy them.
- B. A good is scarce only when its market price is positive.
- C. Every consumer has the same wants but different incomes.
- D. A government can eliminate scarcity by increasing the money supply.

QUESTION 3

A production possibility boundary shifts outward. Which change could cause this? (1 mark)

- A. A fall in the utilisation of existing resources.
- B. A rise in the general price level.
- C. An improvement in production technology.
- D. A movement from an interior point to a point on the boundary.

QUESTION 4

A consumer's demand for good X increases when the price of good Y rises. X and Y are most likely (1 mark)

- A. complements.
- B. substitutes.
- C. unrelated goods.
- D. inferior goods.

QUESTION 5

In the short run, a firm's total product rises from 100 units to 132 units when labour increases from 5 workers to 6 workers. The marginal product of the sixth worker is (1 mark)

- A. 22 units.
- B. 27.5 units.
- C. 32 units.
- D. 132 units.

QUESTION 6

A firm increases all its inputs by 10% and its output rises by 15%. The firm experiences

(1 mark)

- A. decreasing returns to scale.
- B. constant returns to scale.
- C. increasing returns to scale.
- D. diminishing marginal returns to the variable input.

QUESTION 7

A firm's total fixed cost is \$500 when it produces 0, 10 or 20 units. When output rises from 10 to 20 units, its average fixed cost

(1 mark)

- A. rises from \$50 to \$100.
- B. falls from \$50 to \$25.
- C. remains unchanged at \$50.
- D. falls to zero.

QUESTION 8

A firm's marginal cost is below its average total cost. As output increases slightly, average total cost will

(1 mark)

- A. fall.
- B. rise.
- C. remain unchanged.
- D. become equal to average fixed cost.

QUESTION 9

The price of a good rises, causing quantity demanded to fall along an unchanged demand curve. This is

(1 mark)

- A. a decrease in demand.
- B. an increase in demand.
- C. a contraction in quantity demanded.
- D. a fall in supply.

QUESTION 10

At the prevailing market price, quantity demanded is greater than quantity supplied. In a competitive market, this excess demand tends to cause

(1 mark)

- A. downward pressure on price.
- B. upward pressure on price.
- C. a fall in demand.
- D. a permanent increase in supply.

QUESTION 11

Demand for takeaway meals increases while supply decreases. Which conclusion is necessarily correct, assuming the usual downward-sloping demand and upward-sloping supply curves? (1 mark)

- A. Equilibrium price rises, while the effect on equilibrium quantity is uncertain.
- B. Equilibrium price falls, while equilibrium quantity rises.
- C. Equilibrium quantity falls, while equilibrium price is unchanged.
- D. Both equilibrium price and quantity rise.

QUESTION 12

The price elasticity of demand for a product is -0.4. If its price rises by 10%, the approximate change in quantity demanded is (1 mark)

- A. a 4% increase.
- B. a 4% decrease.
- C. a 25% decrease.
- D. a 10% decrease.

QUESTION 13

A binding price ceiling is imposed below the market equilibrium price. Which outcome is most likely, assuming no other change? (1 mark)

- A. A surplus and a fall in quantity exchanged.
- B. A shortage and a fall in quantity exchanged.
- C. A shortage and an increase in quantity exchanged.
- D. No effect, because the ceiling is legally imposed.

QUESTION 14

A firm in perfect competition is a price taker because (1 mark)

- A. its product has no close substitutes.
- B. it sells a negligible share of a market with many firms and homogeneous products.
- C. it faces a downward-sloping market demand curve as an individual firm.
- D. entry into the industry is legally prohibited.

QUESTION 15

A monopolistically competitive firm earns supernormal profit in the short run. If entry is free and products are differentiated, entry by new firms tends to (1 mark)

- A. shift the firm's demand curve left and reduce its profit.
- B. shift its marginal cost curve down and increase profit.
- C. make its demand perfectly elastic.
- D. eliminate product differentiation.

QUESTION 16

A dominant firm faces a kinked demand curve because rivals are expected to

(1 mark)

- A. match price increases but ignore price decreases.
- B. ignore price increases but match price decreases.
- C. match all price changes exactly.
- D. leave the industry whenever the dominant firm changes price.

QUESTION 17

In the long run, a perfectly competitive firm in equilibrium normally produces where

(1 mark)

- A. price equals marginal cost and minimum average total cost.
- B. price is greater than marginal cost and average total cost.
- C. marginal revenue is zero.
- D. price equals average variable cost but is below average total cost.

QUESTION 18

A factory's emissions impose health costs on nearby residents that are not paid by the factory or reflected in the product's price. This is an example of

(1 mark)

- A. a positive production externality.
- B. a negative production externality.
- C. a public good.
- D. a progressive tax.

QUESTION 19

A per-unit tax on a good with a negative production externality is intended primarily to

(1 mark)

- A. make producers take more of the external cost into account and reduce output toward the socially efficient level.
- B. increase output by lowering the marginal private cost.
- C. transfer all consumer surplus to producers without affecting output.
- D. ensure that every consumer pays the same total tax regardless of quantity purchased.

QUESTION 20

A tax system is progressive when

(1 mark)

- A. the average tax rate rises as income rises.
- B. everyone pays the same absolute amount of tax.
- C. the marginal tax rate is always below the average tax rate.
- D. the tax revenue is used only to fund transfer payments.

QUESTION 21

A policy redistributes income from higher-income households to lower-income households. Which statement about its effects is most defensible? (1 mark)

- A. It must increase both equity and economic efficiency.
- B. It may improve equity but could create efficiency costs by changing incentives; the net effect depends on the policy and circumstances.
- C. It must reduce equity because market incomes are always equitable.
- D. It has no possible effect on resource allocation.

QUESTION 22

Which item is included in Hong Kong's GDP for a year? (1 mark)

- A. The market value of a newly produced locally made machine sold to a local firm.
- B. The resale value of a second-hand flat, excluding fees for current services.
- C. A cash gift transferred between two Hong Kong households.
- D. The value of unpaid household cooking.

QUESTION 23

A price index uses a fixed basket. The index rises from 100 to 104 over a year. The measured inflation rate over the year is (1 mark)

Year	Price index
Start of year	100
End of year	104

- A. 4%.
- B. 104%.
- C. 0.4%.
- D. 104 index points per year, which is the inflation rate.

QUESTION 24

Real GDP rises by 3% while the population rises by 4%. Approximately, real GDP per capita (1 mark)

- A. rises by 7%.
- B. falls by 1%.
- C. rises by 1%.
- D. is unchanged.

QUESTION 25

Which statement is a limitation of using real GDP per capita to compare living standards?

(1 mark)

- A. It does not by itself show how income is distributed among residents.
- B. It adjusts for changes in the general price level.
- C. It measures only the market value of exports.
- D. It necessarily falls whenever the population rises.

QUESTION 26

In the expenditure approach to measuring GDP, which expression is correct?

(1 mark)

- A. $GDP = \text{consumption} + \text{investment} + \text{government expenditure} + \text{exports} - \text{imports}$.
- B. $GDP = \text{consumption} + \text{saving} + \text{taxes}$.
- C. $GDP = \text{exports} + \text{imports} - \text{consumption}$.
- D. $GDP = \text{wages} + \text{transfers} + \text{household wealth}$.

QUESTION 27

In a simple Keynesian model, the marginal propensity to consume is 0.8 and there are no taxes or imports. If autonomous investment rises by \$20 million, equilibrium income rises by

(1 mark)

- A. \$20 million.
- B. \$80 million.
- C. \$100 million.
- D. \$400 million.

QUESTION 28

In an economy with spare capacity, an increase in autonomous expenditure is likely, in the short run, to cause

(1 mark)

- A. a rise in real output and aggregate demand, with the size depending on leakages and capacity.
- B. only a rise in the price level, with no change in real output.
- C. a fall in aggregate demand because saving must rise.
- D. a guaranteed equal rise in real output regardless of the marginal propensity to consume.

QUESTION 29

If aggregate demand rises when the economy is already close to full employment, the most likely short-run outcome is

(1 mark)

- A. a larger increase in the price level relative to real output than when substantial spare capacity exists.
- B. a fall in the price level because firms face higher demand.
- C. a guaranteed rise in real output with no inflationary pressure.
- D. no change in either output or the price level.

QUESTION 30

An unexpected rise in the price of imported raw materials is most likely to cause

(1 mark)

- A. cost-push inflation and a leftward shift of short-run aggregate supply.
- B. demand-pull inflation and a rightward shift of aggregate demand.
- C. a fall in firms' costs and a rightward shift of short-run aggregate supply.
- D. a rise in potential output with no effect on current costs.

QUESTION 31

Which function of money is illustrated when a Hong Kong shop displays the prices of goods in Hong Kong dollars?

(1 mark)

- A. Medium of exchange.
- B. Store of value.
- C. Unit of account.
- D. Standard of deferred payment.

QUESTION 32

A commercial bank approves a new loan and credits the borrower's deposit account. This transaction can

(1 mark)

- A. create a bank deposit and expand the money supply, subject to banking constraints.
- B. reduce the borrower's deposit and automatically destroy all bank money.
- C. create central bank notes without any bank liabilities.
- D. increase the bank's reserves by the full loan amount in every case.

QUESTION 33

The Hong Kong dollar operates under a linked exchange rate system. Which statement best describes the main implication for monetary policy?

(1 mark)

- A. The authorities can freely set any interest rate independently of conditions affecting the US dollar without pressure on the link.
- B. Maintaining the link constrains monetary autonomy, so local interest rates are influenced by the need to defend the exchange-rate arrangement.
- C. The link guarantees that Hong Kong's inflation rate always equals that of the United States.
- D. The link prevents all changes in Hong Kong's money supply.

QUESTION 34

A central bank raises its policy interest rate. Other things being equal, which transmission mechanism is most likely to reduce aggregate demand?

(1 mark)

- A. Borrowing becomes more expensive, discouraging some consumption and investment.
- B. The opportunity cost of holding money falls, automatically raising spending.
- C. Firms' expected costs fall, increasing investment in every industry.
- D. Household saving becomes less attractive, reducing consumption and investment.

QUESTION 35

A fall in real GDP over a sustained period accompanied by rising unemployment is most directly associated with (1 mark)

- A. recessionary pressure.
- B. demand-pull inflation.
- C. a current-account surplus by definition.
- D. a rise in potential output.

QUESTION 36

During a downturn, the government increases spending on locally provided infrastructure while holding taxes unchanged. The most direct short-run effect is likely to be (1 mark)

- A. a rise in aggregate demand, with a possible multiplied increase in output if spare capacity exists.
- B. a fall in aggregate demand because government spending is a leakage.
- C. an immediate increase in potential output equal to the full spending amount.
- D. a guaranteed reduction in the price level and no change in employment.

QUESTION 37

Which is an automatic stabiliser? (1 mark)

- A. A discretionary public works programme approved after a recession begins.
- B. Progressive income tax revenue falling automatically when incomes fall.
- C. A central bank decision to raise interest rates after a meeting.
- D. A one-off change in the exchange-rate regime.

QUESTION 38

An economy faces persistent demand-pull inflation. Which policy package is most likely to reduce inflationary pressure, though it may also slow output growth in the short run? (1 mark)

- A. Expansionary fiscal policy and lower interest rates.
- B. Contractionary fiscal policy and higher interest rates.
- C. A subsidy that increases total spending and a reduction in taxes.
- D. A general increase in government purchases financed by borrowing.

QUESTION 39

A government wants to reduce structural unemployment caused by a mismatch between workers' skills and available jobs. Which policy is most directly targeted at this cause? (1 mark)

- A. Retraining and job-matching support for affected workers.
- B. A temporary reduction in interest rates intended only to increase aggregate demand.
- C. A tax on all firms that employ new workers.
- D. A policy that prevents workers from moving between occupations.

QUESTION 40

A government plans a large infrastructure programme during a period of high public debt and near-full employment. Which assessment is most reasonable? (1 mark)

- A. It must raise long-run welfare because all infrastructure projects have benefits greater than costs.
- B. It may raise productive capacity if projects are worthwhile, but financing costs, opportunity costs and short-run inflationary pressure should be assessed.
- C. It cannot affect aggregate demand because infrastructure is a capital good.
- D. It necessarily reduces public debt because all government spending is self-financing.

QUESTION 41

Country A can produce either 12 units of rice or 6 units of textiles using the same resources. Country B can produce either 8 units of rice or 8 units of textiles. Which statement is correct? (1 mark)

- A. A has a comparative advantage in both goods because it produces more rice.
- B. A has a comparative advantage in rice, while B has a comparative advantage in textiles.
- C. B has a comparative advantage in both goods because it produces more textiles.
- D. Neither country can gain from trade because their production possibilities differ.

QUESTION 42

A tariff is imposed on an imported good in a small importing country. Assuming no other changes, the tariff is most likely to (1 mark)

- A. raise the domestic price, increase domestic production and reduce domestic consumption of the good.
- B. lower the domestic price and increase imports.
- C. leave the domestic price unchanged because the country is small.
- D. raise world supply and guarantee a net gain in national welfare.

QUESTION 43

If the Hong Kong dollar appreciates against another currency, other things being equal, which effect is most likely? (1 mark)

- A. Hong Kong exports become cheaper to foreign buyers and imports become more expensive to Hong Kong buyers.
- B. Hong Kong exports become more expensive to foreign buyers and imports become cheaper to Hong Kong buyers.
- C. Both exports and imports become cheaper to Hong Kong residents.
- D. The exchange-rate change has no possible effect on trade flows.

QUESTION 44

A country's current account records a deficit in a particular year. Which statement is correct? (1 mark)

- A. The country must have had a government budget deficit in the same year.
- B. Its recorded current-account payments exceed receipts, but this alone does not establish that the deficit is unsustainable or undesirable.
- C. Its exports of goods must exceed its imports of goods.
- D. It has no capital or financial account transactions.

QUESTION 45

An economy's currency depreciates. Its export demand is price elastic and its import demand is price inelastic in the short run. Which conclusion is most appropriate, other things being equal? (1 mark)

- A. The value of exports is likely to rise and the value of imports is likely to rise, so the trade balance must improve immediately.
- B. Export quantities may respond substantially, while import quantities respond less; the value of the trade balance need not improve immediately and may follow a J-curve pattern.
- C. Export quantities must fall because foreign buyers pay fewer units of the depreciating currency.
- D. The trade balance must remain unchanged because depreciation affects only financial transactions.