

Economics Express Educational School
Hong Kong Advanced Level Mock Examination
AL Economics Paper 1 / AS Economics

Section A

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|------|-------|-------|-------|-------|-------|
| 1. C | 6. D | 11. D | 16. C | 21. B | 26. A |
| 2. B | 7. B | 12. D | 17. A | 22. C | 27. D |
| 3. D | 8. B | 13. B | 18. D | 23. D | 28. B |
| 4. B | 9. D | 14. D | 19. D | 24. D | 29. C |
| 5. D | 10. D | 15. D | 20. C | 25. D | 30. D |

Section B

1. Economic rent is defined as the maximum amount that can be charged without affecting specified production dimensions. Its invention is due to the fact that production often involves several dimensions. In general, the total expected income generated from production can be divided into several parts and related to distinct production dimensions. Whether these expected incomes are classified as economic rent or opportunity cost depends on which dimensions of producer behaviour economists expect to be changeable in the analysis. In specifying which part of expected income is economic rent, economists hold some production dimensions constant and let themselves focus on those dimensions in question. In other words, when the production behaviour is not expected to change within the analytical period, the corresponding expected income is regarded as economic rent. If all production dimensions can make a shift, all expected incomes are cost.
2. The invariant proposition of the Coase Theorem posits that with zero transaction costs and well-defined private property rights, the final resources allocation is identical and efficient regardless of whoever owns the private property rights initially. Its core states that private property right is prerequisite for efficient market operation.

The problem is the logical conflict between zero transaction costs and well-defined private property rights. Since the formation of institutional arrangements, afforded by a bundle of property rights, aims to minimize transaction costs and thereby maximize the net social gains from resources allocation, zero transaction costs leave no role for private property rights to play in resources allocation.

3. In economics, both are postulates restricting how testable implications are formulated. Maximization ensures that all conclusions are consistent with the highest gains, and as a rule termed as the 'equilibrium' in economics. The law of demand indicates how economic variables change in direction when there is a change in equilibrium, from which testable

implication can be derived. In fact, maximization and the law of demand are assertions more than mere assumptions in economics. Without these two essences, no economic scientific explanation can be provided.

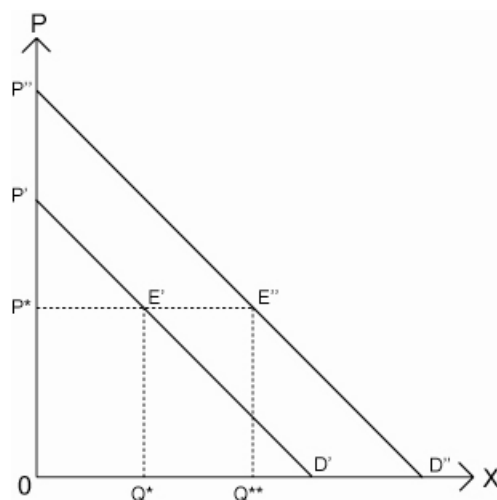
- Although we cannot deduce how much the consumer surplus has been captured in a particular pricing, some ‘directional’ conclusions can still be made in the real world. Once the pricing involves a structure, i.e., having more than one pricing item, some extraction of consumer surplus can be deduced. For example, two-part pricing, all-nothing pricing and multi-part pricing involve extra pricing items such as lump-sum charges, quantity restrictions and finer marginal variations in addition to uniform per-unit price, and therefore less consumer surplus is enjoyed by buyers.

Furthermore, we can also make comparison between pricings in respect of directional change in consumer surplus. When two pricings have all other pricing items equal, any extra addition in pricing items to any one of the pricings will take away more consumer surplus from buyers.

- In the time-rate contracts, payment is made for workers’ contributions indirectly on a per-month, per-day or per-hour basis. The adjustment of these ‘proxies’ is based on ‘time value’ rather than ‘output value’. So, when there is a change in market condition such as fall in preference for products, there is a fall in output value. However, without change in time value, the time-rate will remain intact, giving rise to more serious problem of wage rigidity. While the payments of other contracts such as piece-rate and profit sharing are directly proportional to output value, the corresponding wage payment gets more flexible and sensitive to market change.

In fact, the more the time-rates are adopted all over the economy, the severer the unemployment is suffered, owing to strong wage rigidity.

- The following figure shows a demand curve shifting from D' to D'' in a parallel manner.



By definition, the price elasticity of demand is:

$$ed = \frac{\frac{\Delta Q}{Q}}{\frac{\Delta P}{P}} = \frac{\Delta Q}{Q} \div \frac{\Delta P}{P} = \frac{\Delta Q}{Q} \times \frac{P}{\Delta P} = \frac{P}{Q} \times \frac{\Delta Q}{\Delta P}$$

Then, by substituting the relevant labels in the formula, we have the price elasticity of demand at P^* along the demand curve of D' as:

$$ed = \frac{P}{Q} \times \frac{\Delta Q}{\Delta P} = \frac{0P^*}{0Q^*} \times \frac{P^*E^*}{P^*P^*} = \frac{0P^*}{P^*P^*} \quad (P^*E^* = 0Q^* \text{ in distance})$$

If the same calculation is applied to P^* along the demand curve of D'' , its price elasticity of demand is:

$$ed = \frac{P}{Q} \times \frac{\Delta Q}{\Delta P} = \frac{0P^*}{0Q^{**}} \times \frac{P^*E^{**}}{P''P^*} = \frac{0P^*}{P''P^*} \quad (P^*E^{**} = 0Q^{**} \text{ in distance})$$

Obviously, the price elasticity of demand falls with a parallel upward shift in demand curve.

Section C

7. The fixed amount subsidy lowers the relative value of large bank deposits, and so people tend to make less deposit in large banks.
8. (a) Short-distance routes and long-distance routes are not in substitute and therefore their relative prices cannot be measured in terms of each other.
(b) A rise in relative price can be associated with a fall in all money prices. This raises welfare.
9. (a) On the one side, more commercial premises raise net rental value by reducing customers' search cost. On the other side, they lower net rental value by intensifying competition and adding heavy administrative cost. The optimal number of commercial premises is obtained when the gain and loss in rental value are brought into equality at the margin.
(b) Economic prosperity raises time value. This further saves customers' search cost, and so the number of commercial premises rises. However, when the number grows to a certain level, the prohibitively high administrative cost may end up with one superstore only.