

**ECONOMICS PAPER 2  
Question-Answer Book**

10.15 am – 12.15 pm (2 hours)  
This paper must be answered in English

**INSTRUCTIONS**

- (1) After the announcement of the start of the examination, you should first write your Candidate Number in the space provided on Page 1 and stick barcode labels in the spaces provided on Pages 1, 3, 5, 7, 9 and 11.
- (2) This paper consists of three sections, A, B and C. Answer ALL questions in sections A and B. Attempt any ONE question in section C.
- (3) Write your answers in the spaces provided in this Question-Answer Book. Do not write in the margins. Answers written in the margins will not be marked.
- (4) Supplementary answer sheets will be supplied on request. Write your candidate number, mark the question number box and stick a barcode label on each sheet, and fasten them with string **INSIDE** this book.
- (5) No extra time will be given to candidates for sticking on the barcode labels or filling in the question number boxes after the 'Time is up' announcement.

Please stick the barcode label here.

Candidate Number

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Section A (50 marks)

1. In Hong Kong, there are many travel agencies providing tour groups and booking services for air tickets. Give **TWO** reasons to explain why the market structure of travel agencies in Hong Kong is **NOT** perfect competition. (4 marks)

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2. The Hong Kong government plans to introduce the “Hong Kong Property for Hong Kong Residents” policy. The flats built under the policy can only be sold to Hong Kong permanent residents within 30 years.

- (a) What are private property rights? Explain why the private property rights over the flats may be weakened under this policy. (4 marks)
- (b) Compared with similar flats in the same district without the reselling restriction, would the price of the flats under this policy be higher or lower? Explain. (3 marks)

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3. (a) What is the relationship between nominal interest rate and real interest rate? (2 marks)
- (b) "When there is actual deflation, the nominal interest rate will be lower than the real interest rate." Do you agree? Explain. (3 marks)

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4. (a) Give ONE reason to explain why the aggregate demand curve is downward sloping. (3 marks)

(b) Suppose there is an increase in the price of raw materials. With reference to the market adjustment mechanism from the short run equilibrium to the long run equilibrium, explain the long run effect of the above change on the price level with the aid of Figure 1. (9 marks)

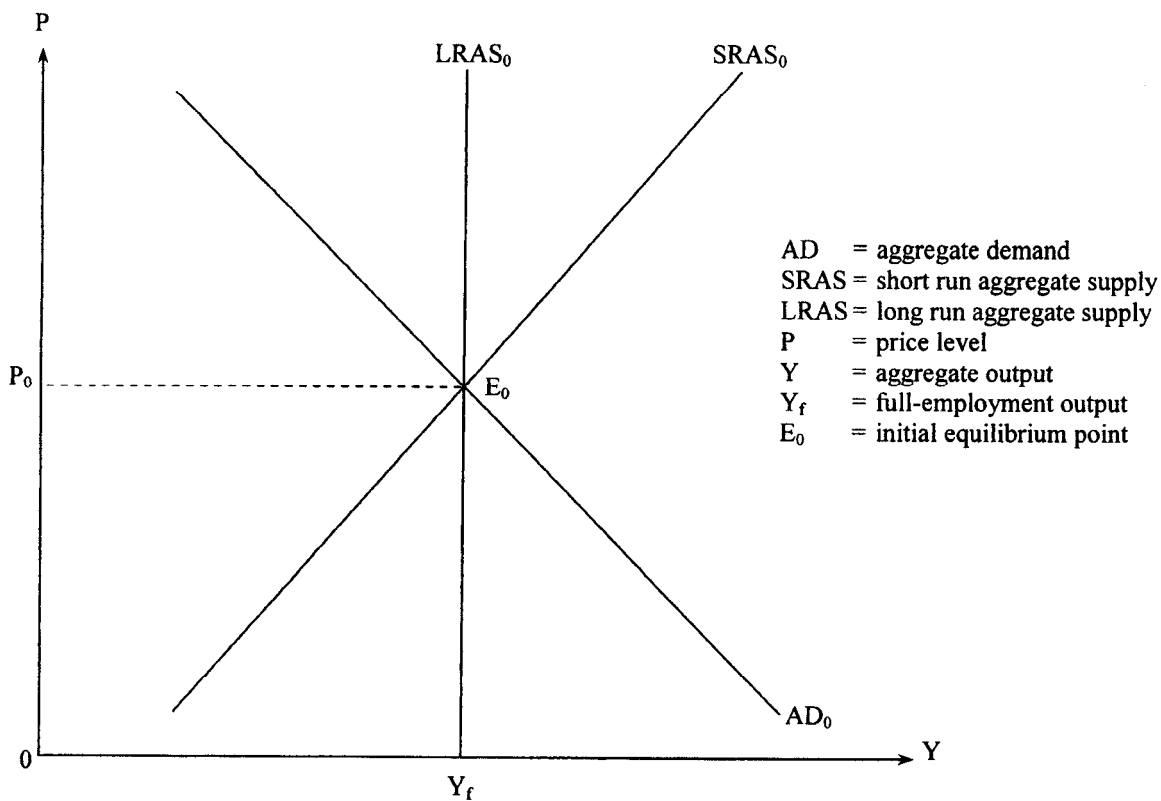


Figure 1

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5. Each unit of resources can be used to produce the following amount of goods in Country A and Country B:

	Food (units)	OR	Smartphones (units)
Country A	30	OR	40
Country B	40	OR	80

- (a) Explain which country has a comparative advantage in the production of smartphones. (3 marks)
- (b) Suppose the transportation cost per unit of smartphones traded is 0.2 units of food. Is it possible to have mutually beneficial trade between these two countries? Explain. (3 marks)

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6. The table below shows the items of the balance of payments of Country A in a certain year:

	Debit (\$ million)	Credit (\$ million)
Export of goods		35
Import of goods	50	
Export of services		47
Import of services	27	
Capital inflow		70
Capital outflow	85	
Foreign exchange and reserves assets		10
Total	162	162

- (a) Calculate the current account balance of Country A. (1 mark)
- (b) "Country A has a balance of payments surplus because there is an increase in foreign exchange reserves in that year." Explain whether you agree with this statement. (3 marks)

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7. Table 1 shows the Gini coefficients by occupation of Hong Kong in the years 2006 and 2011.

Table 1	Gini Coefficient	
	2006	2011
Construction	0.362	0.385
Financing, insurance, real estate and business services	0.544	0.548

(a) According to Table 1, which occupation has a smaller income inequality among its workers? Give TWO possible reasons that account for such a difference in income inequality. (4 marks)

Table 2 shows the employment distribution by industry section of Hong Kong in the years 2006 and 2011.

Table 2	Employment Distribution by Industry Section	
	2006	2011
Construction	8.0%	7.7%
Financing, insurance, real estate and business services	17.0%	19.2%

Table 3 shows the Gini coefficients of Hong Kong in the years 2006 and 2011.

Table 3	2006	2011
Gini Coefficient	0.533	0.537

(b) How may the data given in Tables 1 and 2 help explain the change in the income inequality of Hong Kong as reflected in Table 3? (4 marks)

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\* Table 1 and Question 7(a) refer to the classification by occupation. In the original document, the classification is "by industry" instead of "by occupation".

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8. Suppose a government is facing a budget deficit. Some politicians have proposed that the government should raise the income tax rate to reduce the budget deficit. Evaluate their proposal. (4 marks)

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**END OF SECTION A**

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**Section B (54 marks)**

9. The following is an extract from a local newspaper article.

The MTR Corporation raised the railway fares by 5.4% in 2012. This increase was based on the Fare Adjustment Mechanism set by the government. To respond to the discontent of the public over the fare increase, the Corporation introduced a concessionary measure “Ride 10 Get 1 Free”.

- (a) With the aid of a diagram, explain under what condition the total expenditure of passengers on the MTR will increase because of the rise in fare. (5 marks)
- (b) Under the “Ride 10 Get 1 Free” scheme, with 10 fare-paying journeys on the MTR from Monday to Friday in the same week, passengers could get a single journey ticket for free. Is the free journey a free good? Explain. (2 marks)
- (c) It was observed that there were queues of passengers redeeming the free tickets at customer service counters in MTR stations. Suppose the waiting time is the same for these passengers, is the cost of redeeming the free tickets necessarily the same to these passengers? Explain. (3 marks)

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10. There are cooks, waiters, managers and receptionists working in restaurants.

- (a) What economic principle is illustrated by the above phenomenon? List **THREE** reasons why the principle can increase labour productivity. (4 marks)
- (b) The following is a job advertisement for a manager in a restaurant.

<p>Manager</p> <p>Working hours: 12:00 noon – 10:00 p.m. 6 days a week Salary: \$15 000 per month + performance-related bonus</p>
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- (i) From the viewpoint of the restaurant owner, explain **ONE** advantage of the above payment method over time rate. (2 marks)
- (ii) From the viewpoint of the manager, explain **ONE** advantage of the above payment method over a profit-sharing scheme. (2 marks)
- (c) The Hong Kong government has introduced an effective minimum wage. Subsequently, many restaurant owners claim that they are unable to employ enough workers for their restaurants at the minimum wage rate. With the aid of a demand-supply diagram, explain why the above phenomenon may arise. (9 marks)

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11. The government has launched the “Work Incentive Transport Subsidy Scheme”, with the following objectives:

(1) To relieve the burden of travelling expenses commuting to and from work on the part of low-income households with employed members

(2) To promote sustained employment

Applicants must meet the monthly income and asset limits of the household (e.g. for a single person, the monthly income cannot exceed \$7 300 and the assets cannot exceed \$72 000) and work no less than 72 hours per month in order to apply for a subsidy of \$600 per month.

(a) Do you think that the scheme can achieve the above two objectives? Explain. (4 marks)

(b) Discuss the effects of the scheme on

(i) labour mobility,

(ii) income inequality, and

(iii) the unemployment rate.

(9 marks)

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12. The following table shows the balance sheet of the banking system of an economy.

Assets (\$million)		Liabilities (\$million)	
Reserves	400	Deposits	2 000
Loans	1 600		

The public holds \$1 000 million cash and all banks are fully loaned up.

- (a) Calculate the monetary base and the money supply in the economy. Show your workings. (4 marks)
- (b) If the required reserve ratio is adjusted to 25%, calculate the new money supply in the economy. Show your workings. (2 marks)
- (c) With the aid of an aggregate-demand-aggregate-supply diagram, explain the short run effects of an upward adjustment of the required reserve ratio on output and the price level of the economy. (8 marks)

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**END OF SECTION B**

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**Section C (16 marks) Answer any ONE question.**

**Elective 1**

13. (a) Figure 2 shows the demand curve faced by a monopolist. The monopolist has a constant average cost of production. With the aid of Figure 2, explain why simple monopoly pricing may lead to economic inefficiency. (7 marks)

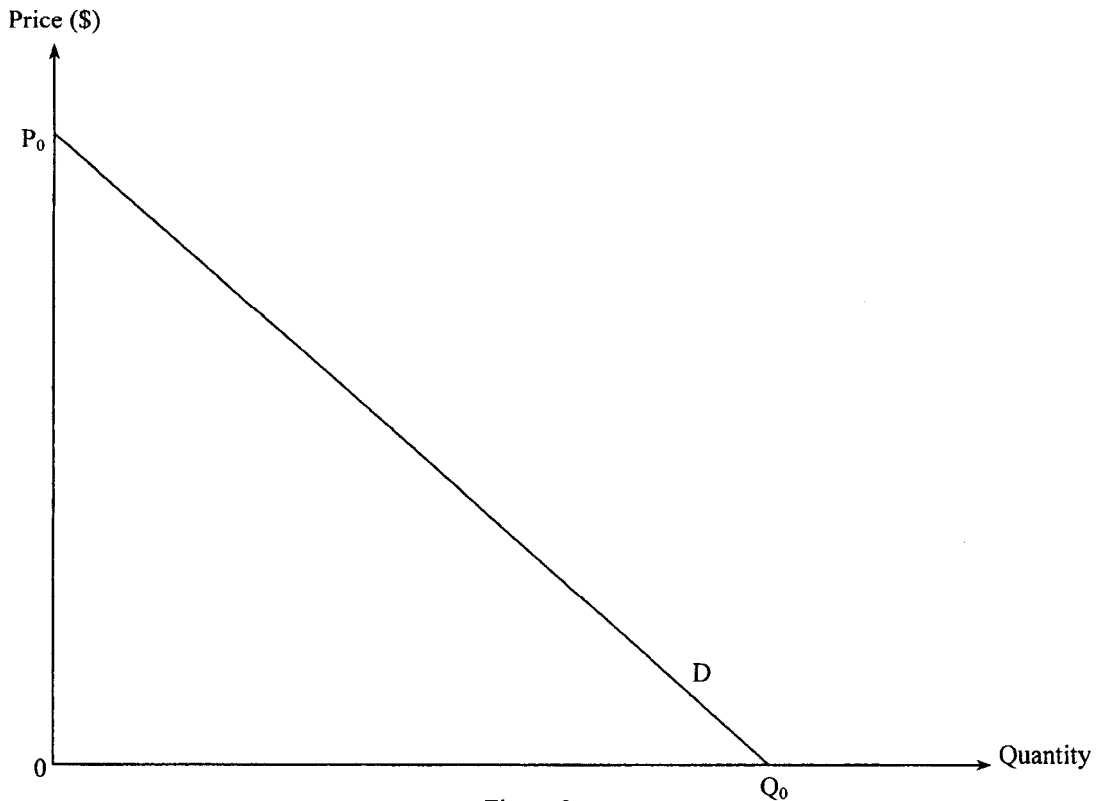


Figure 2

- (b) A retailer offers discounts to tourists who are able to present their travel documents at the cashier. Does this practice constitute price discrimination? Explain. (3 marks)
- (c) Name the anti-competitive behaviour that each of the following cases may constitute and explain how such behaviour restrains competition. (4 marks)
- (i) An instant noodle supplier does not supply its product to a local retailer because the retailer refuses to comply with the recommended price set by the supplier.
  - (ii) One of the major bus companies reduces its fares to a level below its cost of production.
- (d) Explain ONE concern when introducing a competition policy. (2 marks)

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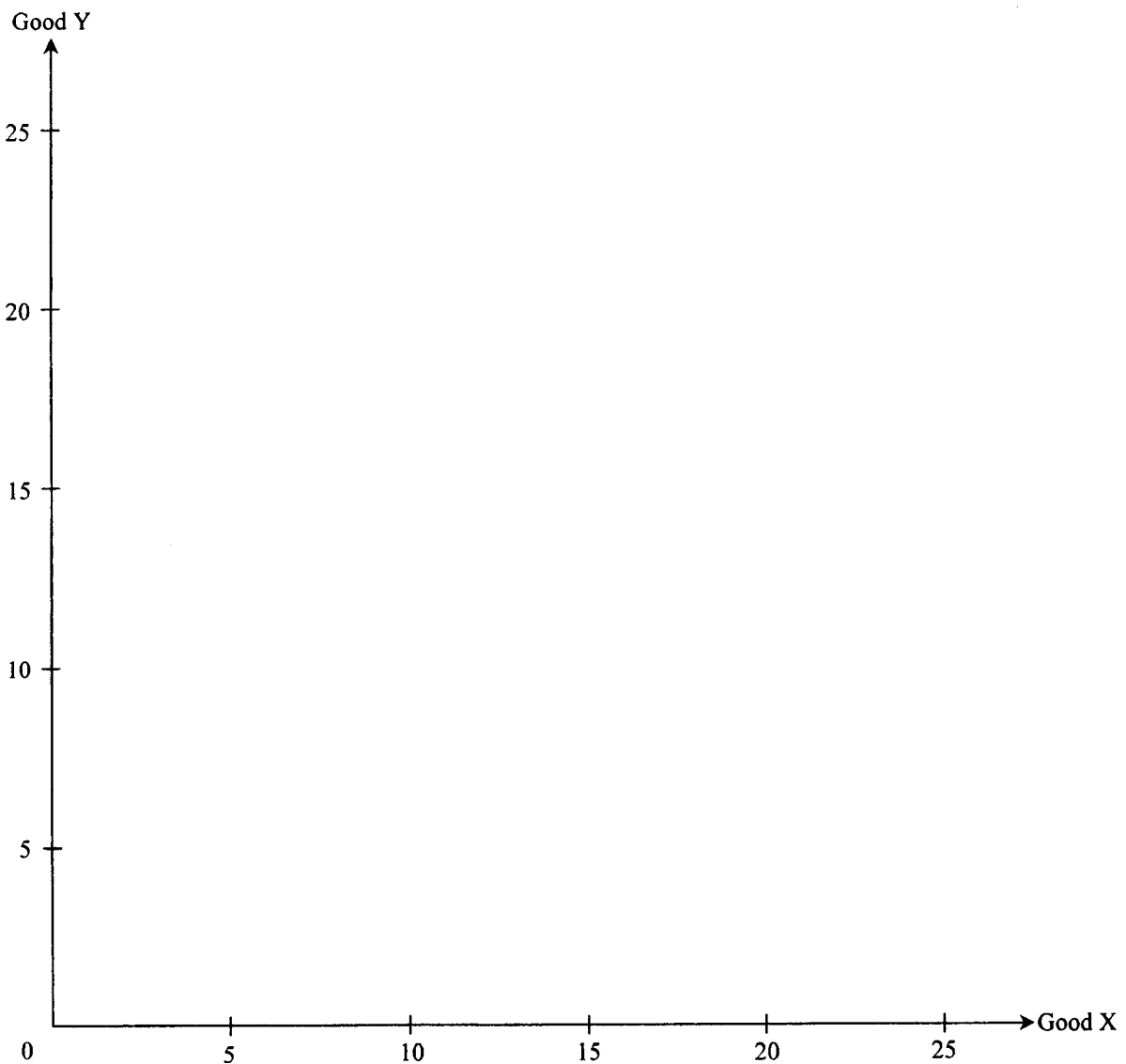
**Elective 2**

14. (a) Country A requires 1 unit of labour to produce a unit of Good X and 2.5 units of labour to produce a unit of Good Y. Suppose labour is the only resource required for production. Country A is endowed with 10 units of labour and the terms of trade is  $1X = 1Y$ .

- (i) Explain which good Country A will import.
- (ii) Construct the production possibilities frontier and consumption possibilities frontier of Country A in Figure 3. (4 marks)

Suppose the labour force of Country A increases by 10 units.

- (iii) Will the direction of trade be affected? Will Country A be better off as a result? Explain your answers with the aid of Figure 3. (6 marks)



**Figure 3**

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(b) Refer to the following information about Hong Kong and Japan in 2011 and answer the following questions.

	Human Development Index (HDI) rank	Gross National Income per capita rank MINUS HDI rank
Japan	12	11
Hong Kong	13	-4

- (i) Which place had a higher Gross National Income per capita in 2011? Show your workings.
- (ii) State **TWO** possible reasons why Japan had a higher HDI rank than Hong Kong in 2011.
- (iii) Suggest **ONE** government policy that could raise Hong Kong's HDI rank.

(6 marks)

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**END OF PAPER**

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

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**Supplementary Answer Sheet**

Question No. \_\_\_\_\_

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