

**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. A good which is free-of-charge is a free good. Do you agree? Explain.

(3 marks)

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2. The table below shows the input-output relationship of a firm.

Worker (Units)	Machine (Units)	Total output (Units)
10	1	10
15	2	23
20	3	42
25	4	62
30	5	80

State the law of diminishing marginal returns and explain whether the above data illustrate the law.

(5 marks)

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3. A telecommunication service provider starts a credit company which offers loans to the public.

(a) Explain what type of expansion this is. (2 marks)

(b) List **THREE** possible motives for the above expansion. (3 marks)

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4. According to a report of the United Nations in 2008, the Gini coefficients of Hong Kong and Beijing were 0.53 and 0.22 respectively.

(a) Was the income gap between the rich and the poor in Hong Kong wider or narrower than that in Beijing? (1 mark)

(b) Explain how an increase in the standard tax rate of salaries tax will affect the post-tax Gini coefficient of Hong Kong. (3 marks)

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5. Country A has imposed an effective price ceiling on Good X.

- (a) Suppose Country A eliminates all illegal transactions of Good X. Can this price control ensure all lower income buyers obtain the quantity of Good X they plan to purchase? Explain. (4 marks)
- (b) After the imposition of the price ceiling, many citizens in Country B travel to Country A to purchase Good X. Will the balance of invisible trade of Country A be affected? Explain. (3 marks)
- (c) Suppose the effective price ceiling is lowered. Will the change in price ceiling improve economic efficiency? Explain your answer with the aid of a diagram. (4 marks)

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6. Rising unemployment is one of the phenomena which occurs during economic recession.

(a) State **TWO** losses to society caused by unemployment. (2 marks)

(b) Other than rising unemployment, give **TWO** other economic phenomena which would occur during economic recession. (2 marks)

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7. “9999 gold is preferred to cigarettes when used as money.” Give **TWO** reasons to explain this argument. (4 marks)

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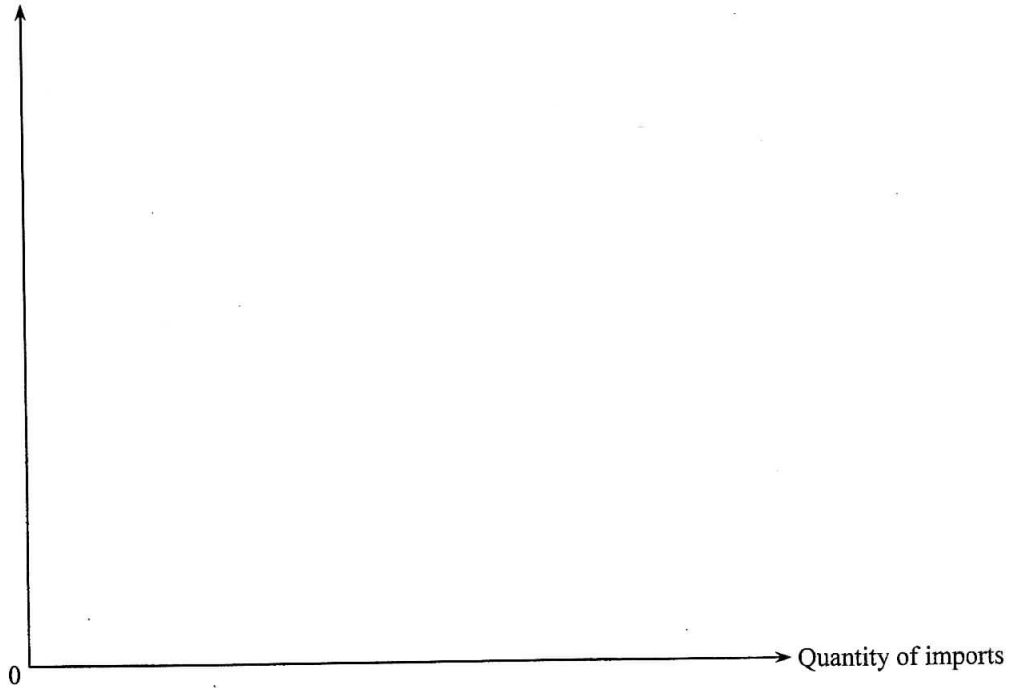
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8. A country's currency depreciates against its trading partners' currencies. Will the depreciation necessarily lower the total import value of this country (in terms of domestic currency)? Explain with the aid of the diagram below. (7 marks)

Price (in terms of domestic currency)



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9. Country A requires 2 working-hours to produce a unit of shirts while Country B requires 1 working-hour. On the other hand, Country A requires 10 working-hours to produce a unit of watches while Country B requires 4 working-hours. Suppose labour is the only resource required for the production of shirts and watches.

- (a) Calculate the opportunity costs of producing 1 unit of shirts (in terms of watches) for Country A and Country B. (2 marks)
- (b) State the principle of comparative advantage. According to this principle, explain which country would export shirts. (3 marks)
- (c) Find the range of terms of trade over which exchange between both countries is mutually beneficial. (2 marks)

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**END OF SECTION A**

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**Section B (54 marks)**

10. In 2011, the Financial Secretary announced the “Scheme \$6000” which provides \$6000 to each Hong Kong permanent resident who is 18 years old or above.
- (a) Mr. Chan is a retired person and received \$6000 through the scheme in 2011.
    - (i) Should this item of payment by the government be included in the calculation of Gross Domestic Product of Hong Kong in 2011? Explain. (2 marks)
    - (ii) Mr. Chan considers investing the \$6000 either in shares or bonds issued by a listed company. Explain with **TWO** reasons why bonds could be a better choice than shares for Mr. Chan. (4 marks)
  - (b) Do you think that the government should introduce the “Scheme \$6000” to improve equity in the Hong Kong society? Explain. (4 marks)
  - (c) With the aid of a diagram, explain how the “Scheme \$6000” would affect the price and output levels of Hong Kong in the long run. (8 marks)

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11. Read the following news extract.

Hong Kong's inflation rate rose to 7.9% last month – the sharpest jump in 16 years – confirming what many families already feared as they struggle to keep up with the runaway cost of food and rent .....

- (a) What is inflation? (2 marks)
- (b) Many workers have their salaries increased during inflation. Explain whether the real income of these workers would necessarily rise. (3 marks)

To relieve the effect of inflation on citizens, the government has issued inflation-linked bonds (ibonds) with interest paid to bondholders every six months. The interest rate is positively related to the actual inflation rate of the last half-year period.

- (c) What is the opportunity cost of holding cash instead of ibonds? (2 marks)
- (d) Explain how ibonds would relieve the effect of inflation on their holders. (2 marks)

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12. The local property market is considered to be overheated.

- (a) Most private housing is constructed by several major property developers in Hong Kong. State the market structure of the private housing market and list **TWO** features of such kind of market structure. (3 marks)
- (b) Chinachem Group is one of the property developers in Hong Kong. Unlike other major developers, Chinachem Group does not list its shares on the stock market. State **TWO** advantages and **TWO** disadvantages of being a private limited company instead of a listed company. (4 marks)
- (c) The government has decided to re-introduce the Home Ownership Scheme in which eligible citizens can purchase a living unit under the scheme at a great discount.
- (i) With the aid of a demand-supply diagram, explain how the re-introduction of the Home Ownership Scheme would cool down the private housing market. (5 marks)
- (ii) **WITHOUT** the aid of a diagram, explain how the mortgage interest rate could be adjusted to cool down the private housing market. (3 marks)

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

Assets (\$million)		Liabilities (\$million)	
Reserves	500	Deposits	2 000
Loans	1 500		

Suppose the public does not hold cash and there are \$100 million excess reserves in the banking system.

- (a) Find the required reserve ratio. Show your working. (2 marks)
- (b) Find the maximum possible amount of deposits if the banks are fully loaned up. Show your working. (2 marks)
- (c) The central bank injects \$200 million newly-printed banknotes into the banking system. If the banks lend out all of their excess reserves, what will the amount of money supply be in the economy? Show your working. (4 marks)
- (d) Based on the quantity theory of money, predict the effect of the monetary policy in (c) on the price level. State the assumption(s) needed to reach your conclusion. (4 marks)

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

14. Large supermarket chains around the world are alleged to practise price discrimination.
- (a) What is price discrimination? (2 marks)
  - (b) State **TWO** conditions for price discrimination. (2 marks)
  - (c) Below are some pricing arrangements among large supermarket chains. Explain whether they constitute price discrimination.
    - (i) Customers pay less for the same products during a promotional period.
    - (ii) Customers with discount coupons pay less for the same products. (6 marks)
  - (d) Some supermarket chains are involved in the following business practices.
    - (1) They agree to raise the prices of the same products simultaneously.
    - (2) They request suppliers not to supply the same products to other sellers.

What kind of anti-competitive business practice is described in each of the above practices? State whether each of the above practices constitutes horizontal agreement or vertical agreement. (4 marks)

- (e) State **TWO** ways in which anti-competitive business practices may harm consumers. (2 marks)

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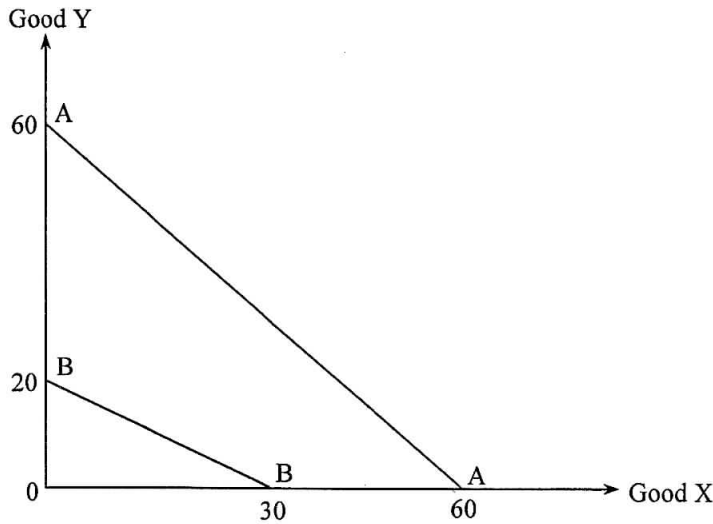
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15. In the diagram below, AA and BB are the production-possibility frontiers of Country A and Country B respectively.



- (a) (i) Which country has a comparative advantage in producing Good X? Explain.  
 (ii) Is mutually beneficial trade possible between these two countries? Explain. (4 marks)
- (b) If the terms of trade is 10 units of X in exchange for 8 units of Y, what will be the gain from trade per unit of X traded for each country? (4 marks)
- (c) Explain whether your answer in (a)(i) would change in the following situations:  
 (i) Country B finds new resources that raise the output of both Good X and Good Y by the same proportion.  
 (ii) Country B discovers a new technology that improves the production method of Good Y. (4 marks)
- (d) The Human Development Index (HDI) of Country B increases after trade.  
 (i) What does HDI measure?  
 (ii) Suggest **ONE** possible reason for such an increase. (4 marks)

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