

ECONOMICS PAPER 2

Question-Answer Book

10:15 am – 12:30 pm (2 hours 15 minutes)
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 and 9.
- (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. More and more famous universities offer “massive open online courses” (MOOC) to students from various backgrounds for systematic learning.
- (a) Most of the teaching materials in MOOC can be accessed online by anyone free of charge. Explain whether these materials are
- (i) free goods; (2 marks)
 - (ii) public goods. (3 marks)
- (b) Some people prefer to take free MOOC while others prefer to take paid courses conducted on the university campus. If the courses are with the same contents and number of teaching hours, will the cost for a person to take a free MOOC be *necessarily* lower than the cost for another person to take a paid on-campus course? Explain. (3 marks)

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2. Many electronic product retailers are located in Mong Kok.

- (a) To which type of production do electronic product retailers belong? Explain your answer. (2 marks)
- (b) Suggest **TWO** reasons why an electronic product retailer in Mong Kok may enjoy external economies of scale. (4 marks)

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5. Macau has developed rapidly in recent years and some workers in Hong Kong have been attracted to work there. Suppose the number of job positions in Hong Kong is constant. What would be the effect of the above phenomenon on the unemployment rate in Hong Kong? Explain your answer. (4 marks)

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6. Study the following balance sheet of the banking system in Country A.

Assets (\$million)		Liabilities (\$million)	
Reserves	1 000	Deposits	5 000
Loans	4 000		

Suppose all banks are fully loaned up and never hold excess reserves. The public always holds \$150 million in cash.

(a) Calculate the following items of this banking system:

- (i) legal reserve ratio (1 mark)
- (ii) money supply (2 marks)

A firm in Country A has received \$50 million from abroad and deposited the sum of money into a bank.

- (b) Calculate the new monetary base in Country A. Show your workings. (2 marks)
- (c) Calculate the new money supply in Country A. Show your workings. (3 marks)

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7. Suppose both Country A and Country B use **ALL** their resources in production. Their maximum output is shown in the table below.

	Rice (units)		Clothing (units)
Country A	15	OR	3
Country B	8	OR	4

- (a) Explain whether Country B has an absolute advantage in producing clothing. (2 marks)
- (b) The rice-exporting country exports 12 units of rice in exchange for 3 units of clothing. Calculate the total gain from trade for the clothing-exporting country. Show your workings. (4 marks)

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8. The government is considering spending a certain sum of its budget surplus on the following two proposals:

Proposal 1: To extend the free education to 15 years

Proposal 2: To provide unemployment benefits

Evaluate the two proposals in terms of *equality* and the *effect on aggregate output*.

(8 marks)

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END OF SECTION A

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Section B (54 marks)

9. McDonald's is one of the major fast food chains in Hong Kong.
- (a) McDonald's is a private limited company in Hong Kong. State **ONE** advantage and **ONE** disadvantage of forming a private limited company over forming a public limited company. (2 marks)
 - (b) McDonald's has expanded its business by operating McCafé, which sells premium coffee like other coffeehouses such as Starbucks. To which type of expansion does this belong? Explain. (2 marks)
 - (c) The price of a cup of Espresso in McCafé is lower than that in Starbucks. Suggest **TWO** possible reasons to explain why there is such a price difference. (4 marks)
 - (d) In July 2014, McDonald's was accused of using expired meat as an ingredient for its food. Later, the related products were destroyed. Explain whether the value of these destroyed products would be included in the calculation of Hong Kong's gross domestic product. (2 marks)

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10. Suppose a football club in Hong Kong hired a famous football player from Brazil as the coach for a 2-month course for kids. He received \$8 million as his salary and returned to Brazil afterwards. However, the enrollment of the course was poor and the revenue from the course was \$3 million only.

(a) What is the effect of organising the above course on each of the following items? Explain.

- (i) Hong Kong's gross domestic product (GDP) (2 marks)
- (ii) Hong Kong's gross national product (GNP) (3 marks)

(b) The following are contracts for two professional football players.

<u>Contract A</u> Player A: \$10 000 per week
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<u>Contract B</u> Player B: \$8 000 per match + \$10 000 for each goal scored

Explain **TWO** advantages of Contract B over Contract A from the viewpoint of the employer. (4 marks)

(c) Professional football players often retire in their mid-thirties. Although most of them have once been well-paid as footballers, some of them can only find low-paid jobs after retirement. Explain the above phenomenon in terms of labour mobility. (3 marks)

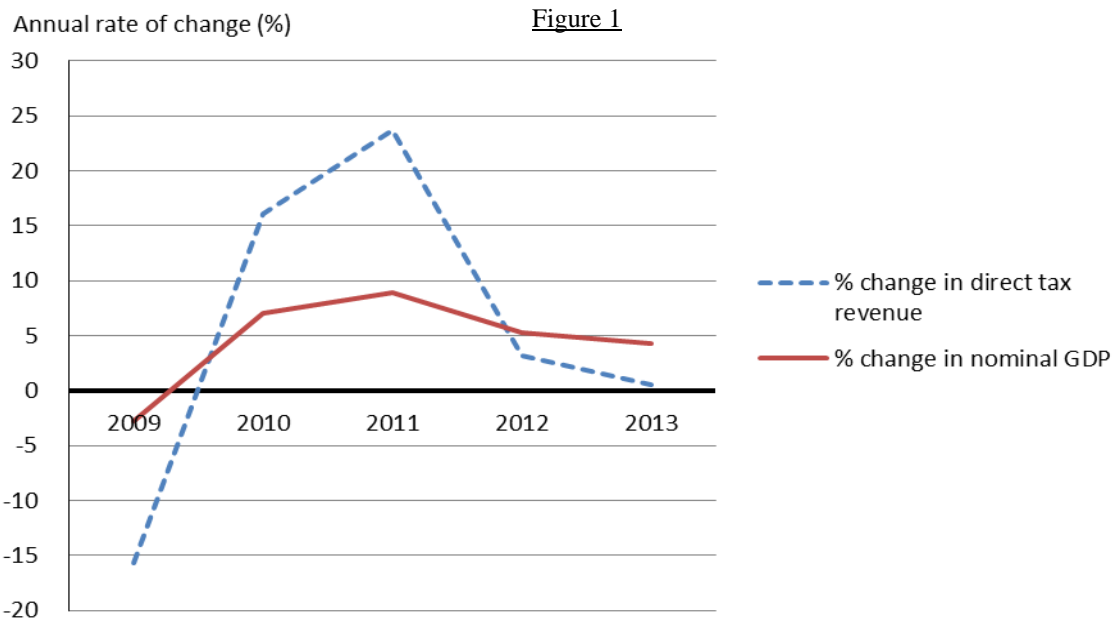
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11. Figure 1 shows the percentage changes in direct tax revenue and nominal GDP in Hong Kong for the years 2009-2013.



- (a) (i) With reference to Figure 1, describe the relationship between the percentage change in direct tax revenue and the percentage change in nominal GDP for the years 2009-2013 and compare their trends. (2 marks)
- (ii) Briefly explain the relationship you described in (a)(i). (2 marks)
- (b) An accountant commented that the tax base of Hong Kong is narrow and suggested the government should introduce new types of indirect tax. Explain, with **ONE** example, how the introduction of a new indirect tax would broaden the tax base. (2 marks)
- Tobacco duty is an indirect tax in Hong Kong. The Financial Secretary has increased the tobacco duty rate with the aim of discouraging smoking.
- (c) An economist stated, “Other things being constant, the rise in the tobacco duty rate would not effectively reduce the quantity consumed of duty-paid cigarettes.” Justify his statement **WITHOUT** using a diagram. (4 marks)
- (d) In addition to the rise in tobacco duty, the Customs has made more effort to prevent the illegal sale of duty-not-paid cigarettes and has cracked down several illegal sellers. Is it possible that the quantity transacted of duty-not-paid cigarettes would increase? With the aid of a diagram, explain your answer. (7 marks)

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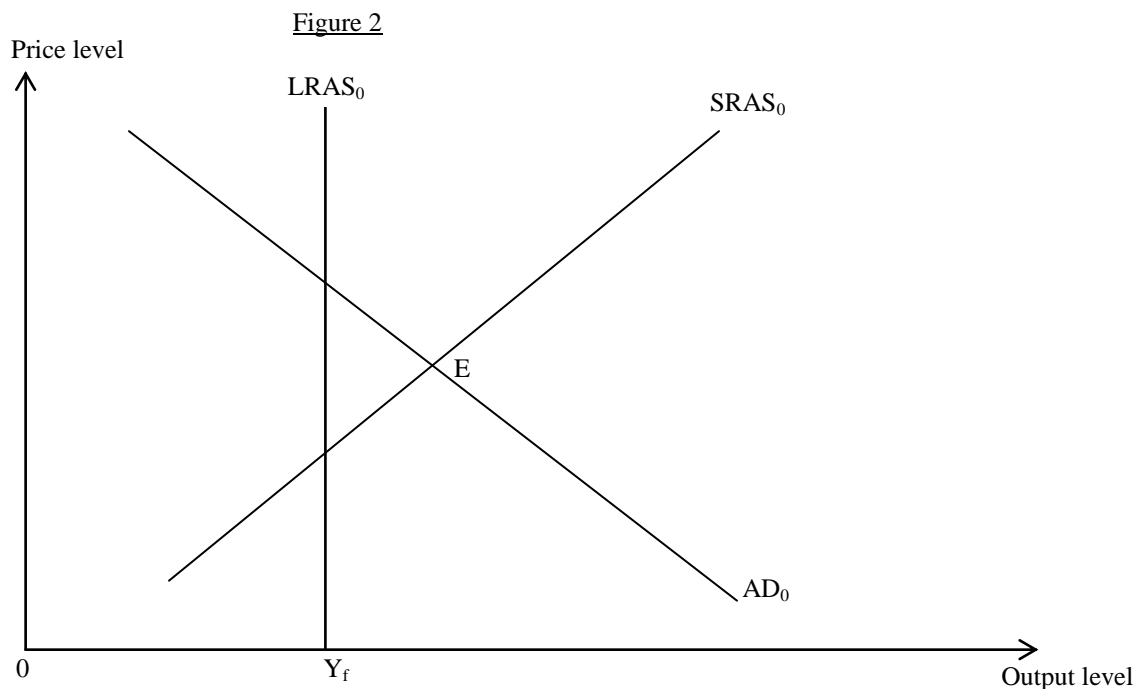
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12. Research shows that the “Individual Visit Scheme” of mainland tourists has brought economic benefits to Hong Kong. However, more and more Hong Kong residents have called on the government to reduce the number of mainland tourists to Hong Kong under the Scheme.

- (a) How would the current account of Hong Kong be affected if the government limited the scale of the Scheme so that the number of tourists from the mainland would drop? Explain your answer. (2 marks)

An economist uses the AS-AD model to analyse the current situation in Hong Kong. In his analysis, point E in Figure 2 represents the initial short-run equilibrium of the Hong Kong economy.



- (b) He points out that the government can help the economy restore to its long-run equilibrium. With the aid of Figure 2, explain how the reduction in the number of tourists from the mainland can lower the output level to Y_f . (5 marks)
- (c) He also states that even without the help of the government, market forces can restore the economy to its long-run equilibrium. **WITHOUT** using a diagram, explain how market forces can lower the output level to Y_f in the long run. (4 marks)
- (d) Some residents complained that the large number of tourists overloaded the public transportation system, resulting in a large increase in travel time for all passengers. Explain, in terms of externality, why inefficiency may exist when the transportation system is overcrowded. (4 marks)

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END OF SECTION B

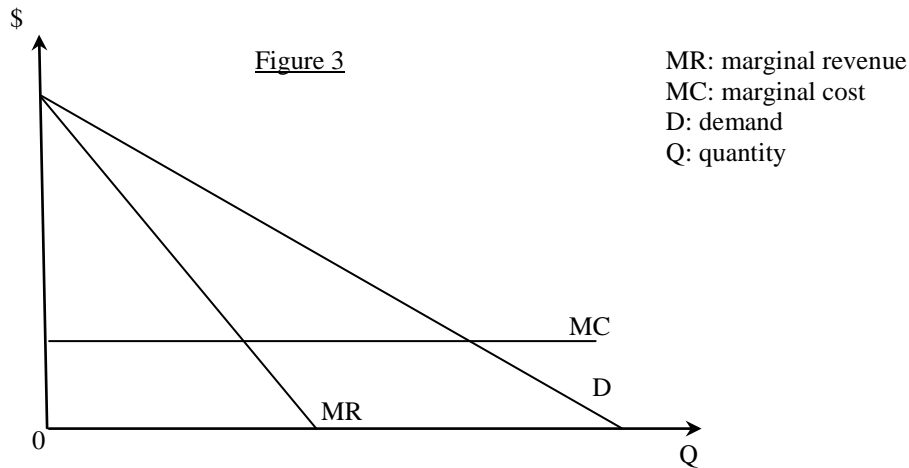
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Section C (16 marks) Answer any **ONE** question.

Elective 1

13. Super Power is the only licensed power supplier in City X. It adopts uniform pricing to maximise its profit.

- (a) Indicate the quantity that it would produce as Q_1 and the corresponding price as P_1 in Figure 3. Briefly explain your answer. (3 marks)



- (b) Explain, with the aid of Figure 3, why it is inefficient to adopt uniform pricing. (2 marks)
- (c) The government imposes a lump sum tax, which is a fixed amount regardless of the quantity produced, on Super Power.
- (i) Explain whether Super Power's marginal cost will increase because of the lump sum tax. (2 marks)
- (ii) Indicate the after-tax output and price of Super Power as Q_2 and P_2 respectively in Figure 3. (2 marks)
- (d) Super Power charges the domestic users \$1.2 per unit of power consumed and the industrial users \$0.9 per unit of power consumed. Does this pricing arrangement constitute price discrimination? Explain. (3 marks)
- (e) Super Power has taken over the major coal supplier, which provides 90% of raw materials for the production of electricity in City X. Name the anti-competitive behaviour that Super Power may constitute and explain how such behaviour restrains competition. (2 marks)
- (f) The owners of Super Power claim the takeover in (e) is not anti-competitive. Justify their claim with **ONE** reason. (2 marks)

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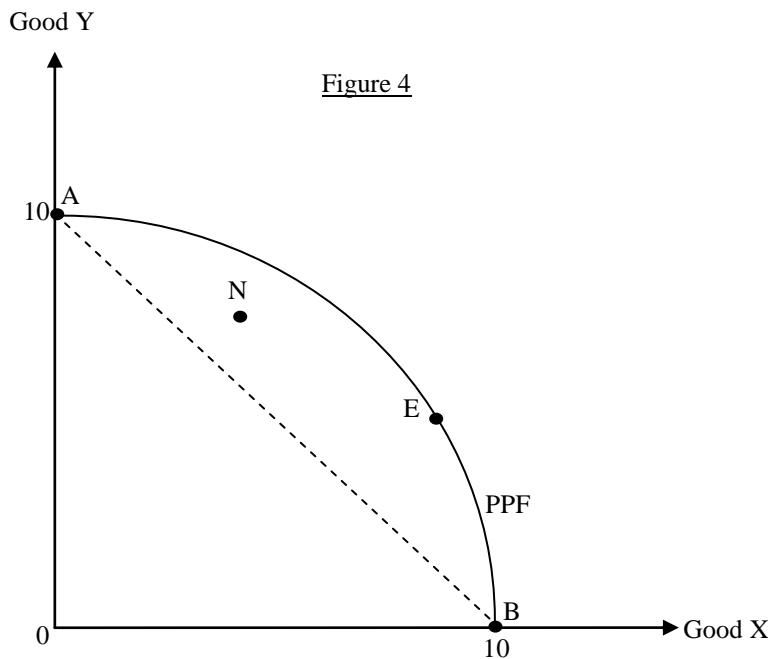
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Elective 2

14. In Figure 4, PPF is a country's production possibility frontier where E is the production point without trade. At point E, the domestic cost of production of one unit of good X is 2.5 units of good Y.



- (a) Explain whether the country would produce at point N. (2 marks)
- (b) The slope of dotted line AB is the world price of good X. Explain whether the country has a comparative advantage in producing good X. (3 marks)
- (c) Suppose the country engages in international trade. Indicate its production point after trade and its consumption possibility frontier in Figure 4. (3 marks)
- (d) With the aid of Figure 4, explain whether the country will gain from trade. (3 marks)
- (e) After the country's opening up for trade, its Human Development Index (HDI) has risen.
 - (i) Give **ONE** reason why international trade can lead to a rise in HDI. (1 mark)
 - (ii) Despite the rise in HDI, the residents in the country generally agree that the living standard has declined. Suggest **TWO** possible reasons to explain their view. (4 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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