

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, 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. Serine is a university graduate who is seeking a job. She has several options and her order of preference is shown below:

First preference:	to work for the government as an administrative officer
Second preference:	to work in an accounting firm as a trainee
Third preference:	to continue to seek a job without accepting any offers

Analyse whether Serine's opportunity cost of choosing to work as an administrative officer will *necessarily* remain unchanged if

- (a) the government reduces the starting salary of administrative officers. (2 marks)
- (b) the government provides unemployment benefits for all graduates seeking jobs. (3 marks)

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2. Ah Wing runs a store selling mobile phone accessories in Mong Kok.

- (a) To what factor of production does Ah Wing belong? Explain your answer. (2 marks)
- (b) Give **ONE** example of variable cost incurred in Ah Wing's business. Explain your answer. (2 marks)
- (c) Identify the market structure of mobile phone accessories retailers in Hong Kong. Give **TWO** reasons to support your answer. (3 marks)

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3. Figure 1 shows the market supply and demand curves of Good X. Suppose the government raises the price floor from P_a to P_b .

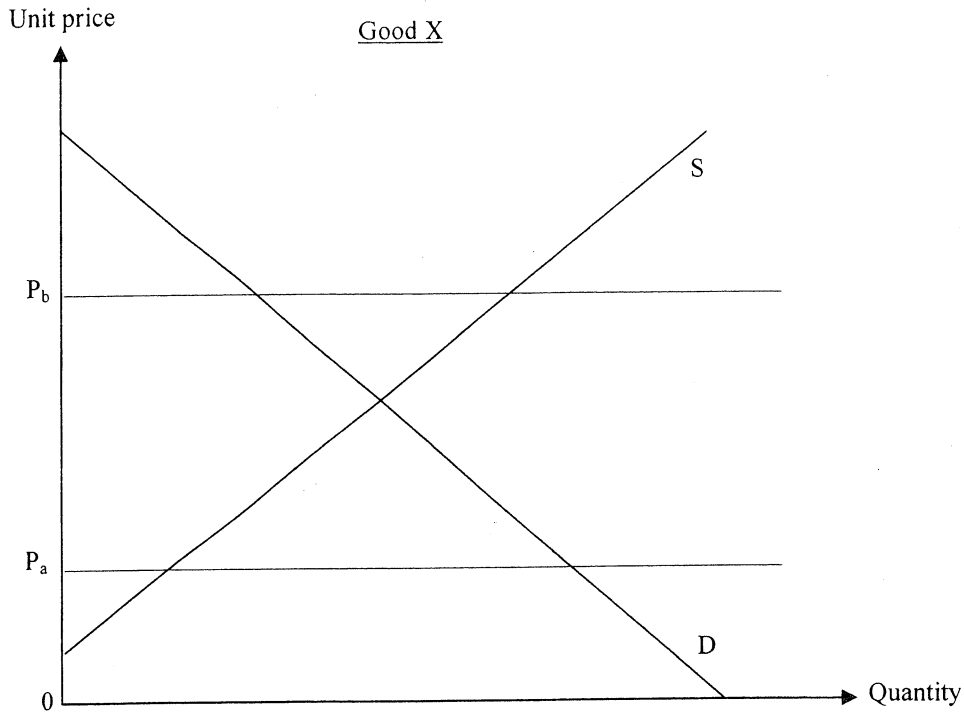


Figure 1

With the aid of Figure 1, explain whether the rise in the price floor could enhance economic efficiency. (6 marks)

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4. Tai Fai Lok Group operates a chain restaurant providing Chinese food.
- (a) Tai Fai Lok Group has recently started Fai Lok Institute, which provides professional training for chefs and managers for Chinese restaurants. To what type of expansion does this belong? Explain your answer. (2 marks)
- (b) Explain **TWO** advantages of such an expansion. (4 marks)

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5. Study the following information about an economy.

Year	Consumer price index (CPI)
2012	120
2013	126

- (a) Calculate the inflation rate in 2013. (1 mark)
- (b) Explain **ONE** difference between using CPI and Gross Domestic Product (GDP) deflator to measure the change in the price level. (2 marks)
- (c) Suppose people did not expect any change in the price level from 2012 to 2013. Explain whether each of the following persons would gain or lose when the change in the price level in the above table occurred.
 - (i) In 2012, Kitman borrowed a housing mortgage loan from a bank at a fixed nominal interest rate.
 - (ii) In 2012, Marlene invested in a project with an expected nominal rate of return of 12% per year. In 2013, she discovered that the actual nominal rate of return was 15% per year. (5 marks)

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6. Karen, a Hong Kong resident, works as a photographer in a media group in Shanghai.
- (a) Would Karen's salary earned in Shanghai be taxed in Hong Kong? Explain your answer. (2 marks)
- (b) Is salaries tax a direct or an indirect tax? Explain your answer. (2 marks)

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7. In an attempt to reduce its growing fiscal deficits, the US government has tried to increase tax on the one hand and decrease fiscal spending on the other. But many worry that such a policy would give rise to undesirable side effects.
- (a) Explain **TWO** possible undesirable effects of the above fiscal policy on the US economy as a whole. (4 marks)
- (b) An alternative policy is to finance the fiscal deficits by printing money. Briefly discuss **ONE** advantage and **ONE** disadvantage of this alternative policy on the US economy as opposed to the above fiscal policy. (4 marks)

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8. Suppose the output of paper and watches per unit of resources of Country A and Country B are as follows:

	Paper (unit)	OR	Watches (unit)
Country A	12	OR	3
Country B	8	OR	4

- (a) Which good would Country B export according to its comparative advantage? Explain. (3 marks)
- (b) Suppose Country A and Country B trade at an exchange ratio of 2 units of watches to 5 units of paper. Calculate the gain per unit of import for Country A. (3 marks)

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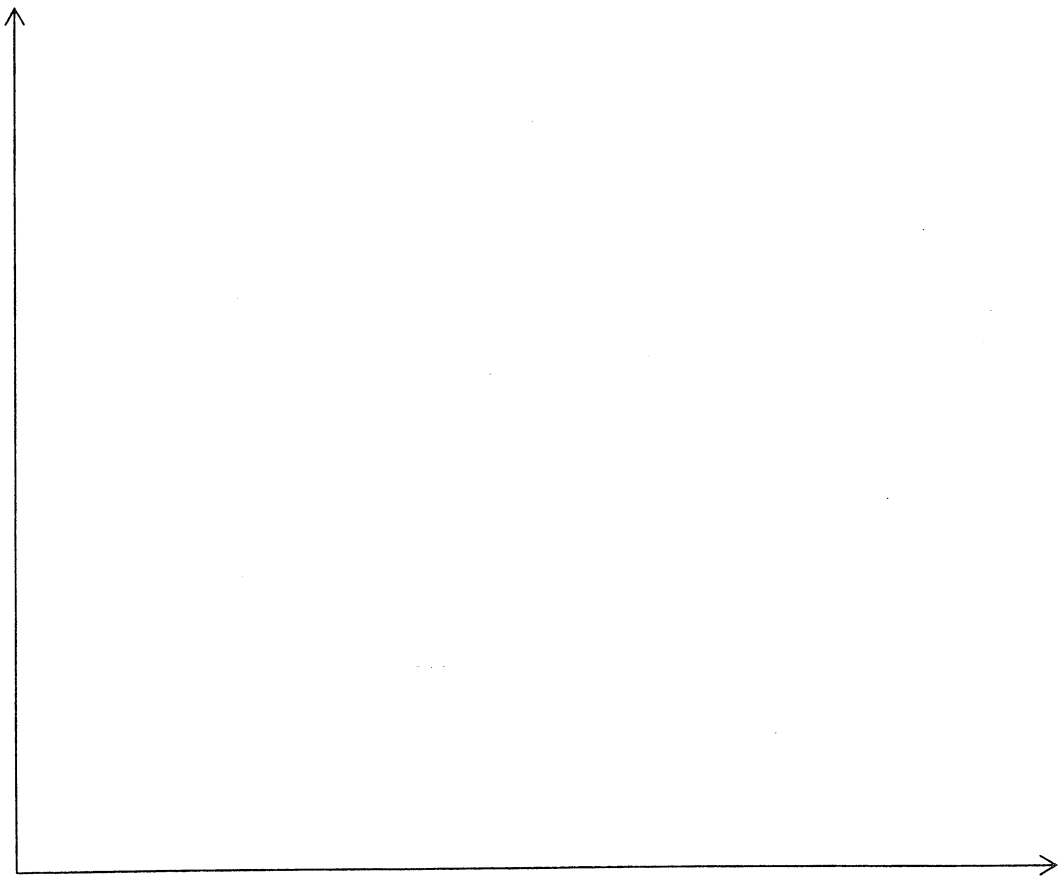
END OF SECTION A

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Section B (54 marks)

9. Many countries have considered imposing 'soft drink tax' for health reasons. Suppose a country decides to impose a per unit tax on the sellers for every bottle of soft drink sold in the market.

- (a) Under what condition will the soft drink buyers in the country bear a greater tax burden than the sellers? Illustrate your answer with a supply-demand diagram. (5 marks)
- (b) Using the same diagram in (a), indicate the change in consumer surplus after the tax is imposed. (1 mark)
- (c) 'As the amount of tax imposed on each bottle is the same irrespective of the bottle size, the proportion of larger-bottle soft drinks sold in the market will increase.' Explain this argument using the law of demand. (5 marks)



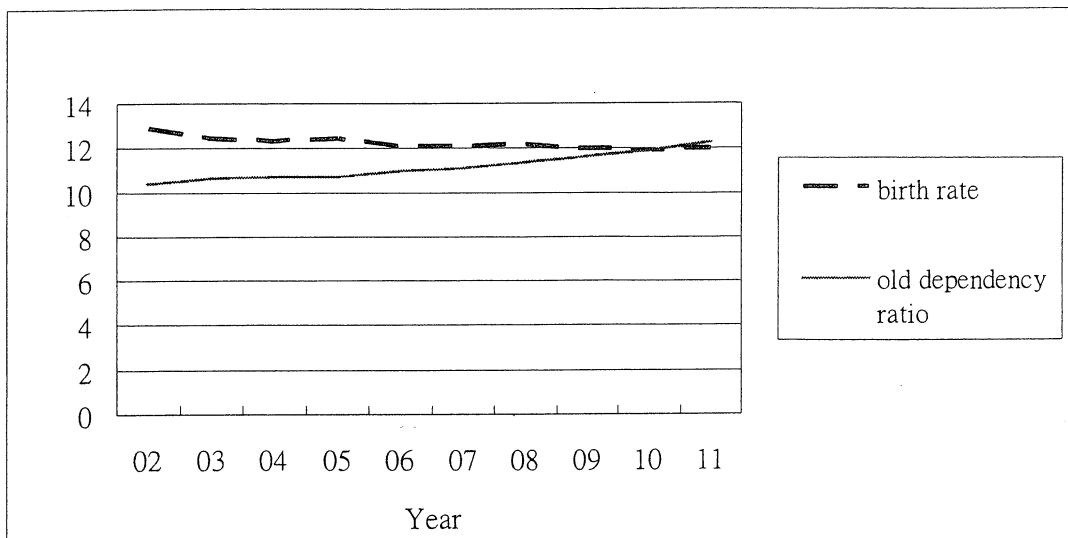
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10. Aging is a serious problem in China.

Source 1 below shows the trends of the old dependency ratio* and the birth rate** of China from 2002 to 2011.



* Old dependency ratio refers to the ratio of the elderly population to the working-age population (expressed in percentage).

** Birth rate refers to the total number of births per 1000 population.

(a) With reference to the trends shown in Source 1, briefly discuss the possible changes on

- (i) government tax revenue in the future.
- (ii) public health and welfare expenditure in the future.

(4 marks)

Source 2 below is an extract from a newspaper article.

Addressing the potential threat brought about by the trends of the birth rate and old dependency ratio in China, government officials are considering relaxing the one-child policy# in an effort to boost the birth rate.

The policy restricts urban couples to only one child, while allowing additional children in several cases, including twins, rural couples, ethnic minorities, and couples who are both the only child in their respective families.

(b) With reference to Source 2, discuss the possible effect on the aggregate output in the long run as a result of the relaxation of the one-child policy. (3 marks)

Goodbaby International (Hong Kong stock code: 1086) is the largest manufacturer and supplier of infants' and children's products in China.

(c) To what type of business ownership does Goodbaby International belong? (1 mark)

(d) Explain the differences between partnership and the type of ownership in (c) in terms of

- (i) transfer of ownership.
- (ii) legal status.

(4 marks)

(e) **WITHOUT** using a diagram, explain why the stock price of Goodbaby International increased after the information in Source 2 was published in newspapers. (4 marks)

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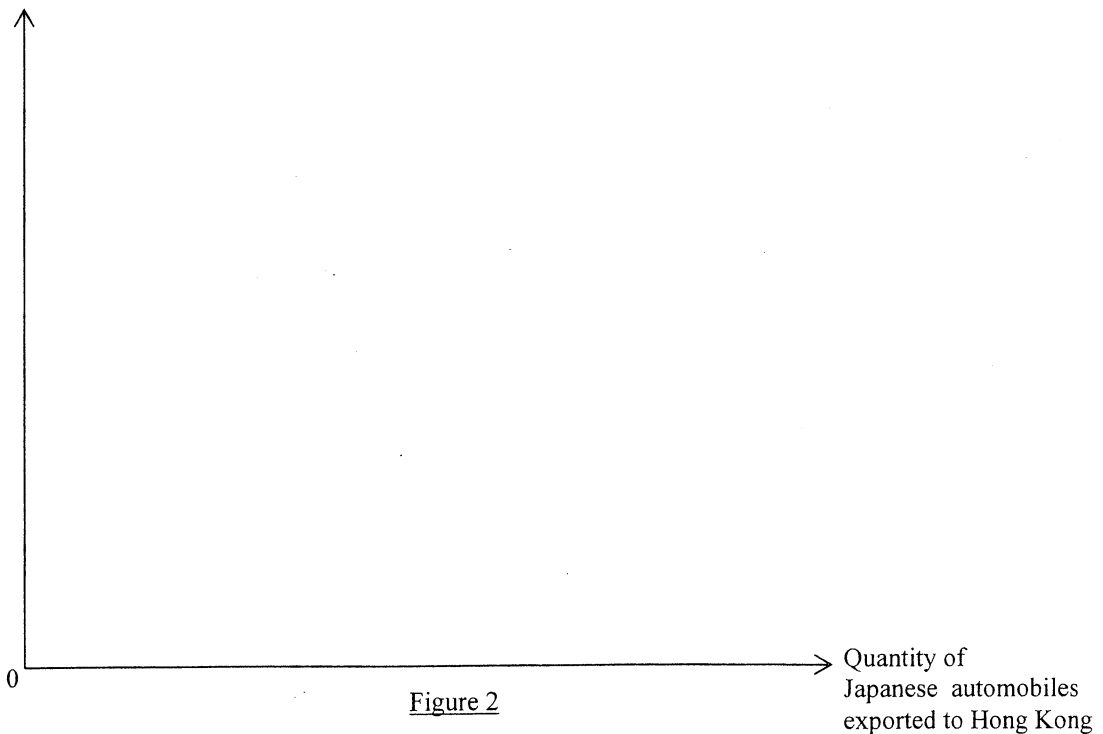
11. The following table shows the change in the exchange rate of the Hong Kong dollar against the Japanese Yen.

Date	Price of 1 unit of Hong Kong dollar
1 st August 2012	10.2 Yen
1 st August 2013	12.5 Yen

Japan exports automobiles to Hong Kong.

- (a) Suppose the price of Japanese automobiles (in terms of Yen) does not change. With the aid of Figure 2, explain why the above change in exchange rate would lead to an increase in the total export value (in terms of Yen) of Japanese automobiles to Hong Kong. (7 marks)
- (b) Suppose the sales revenue to the Japanese automobile exporters was 100 billion Japanese Yen in 2013. Give **TWO** reasons to explain why their contribution to Japan's GDP would be less than 100 billion Japanese Yen in 2013. (4 marks)

Price in terms of
Japanese Yen



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12. The Prime Minister of Japan, Shinzō Abe, adopted a series of policy measures in 2013 to expand the Japanese economy. One of the policy measures was stepping up the scale of the purchase of government bonds and other financial assets by the central bank.

- (a) If the Japanese central bank purchases government bonds from Japanese commercial banks, explain whether the monetary base of Japan would be affected. (3 marks)
- (b) Describe the process of deposit creation/contraction which may result from the purchase of government bonds by the central bank. Explain whether the process would further affect the monetary base of Japan. (5 marks)
- (c) What would be the short run effects of the above policy on the output and price levels of the Japanese economy? Explain your answer with the aid of an aggregate-supply-aggregate-demand diagram. (8 marks)

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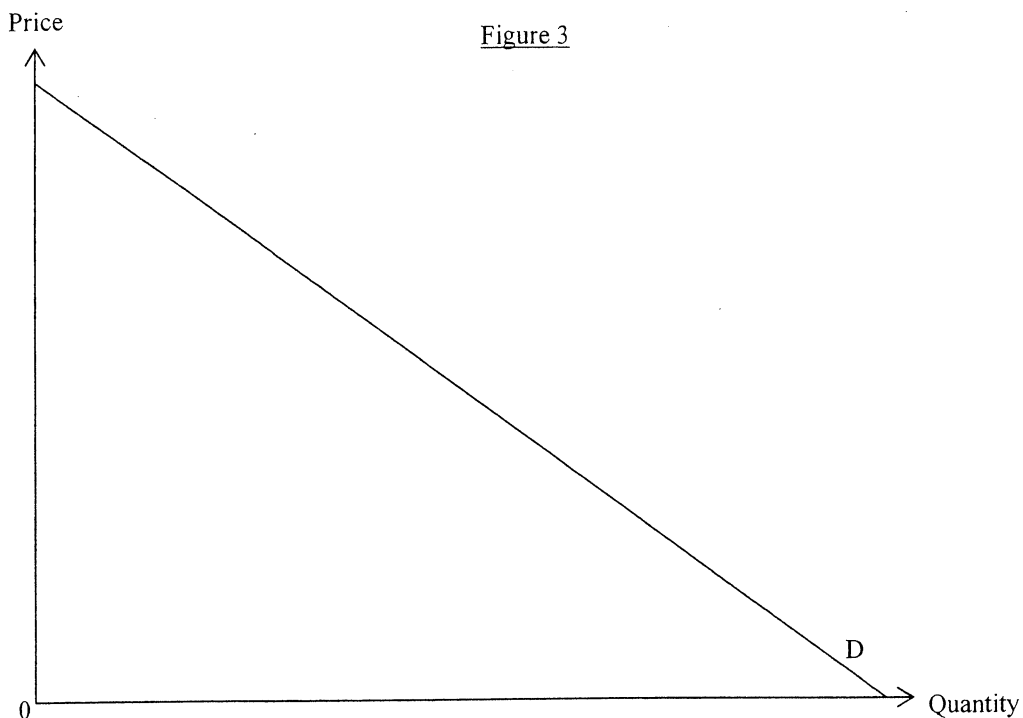
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Section C (16 marks) Answer any ONE question.

Elective 1

13. Ng Fung Hong (五豐行) is the only agent endorsed by the Ministry of Commerce (商務部) to export live cattle to Hong Kong from the mainland.

- (a) With the aid of Figure 3, explain how the profit maximizing output and price of live cattle sold by Ng Fung Hong are determined. Indicate the output and price as Q_m and P_m respectively. (3 marks)



- (b) Suppose the market of exporting live cattle from the mainland is opened for competition and it becomes perfectly competitive. Assume the marginal cost curve remains unchanged, explain the effects of such a change in the market structure on the output and price with the aid of Figure 3. Indicate the new output and price as Q_c and P_c respectively. (4 marks)

Study the following advertisement of a supermarket.

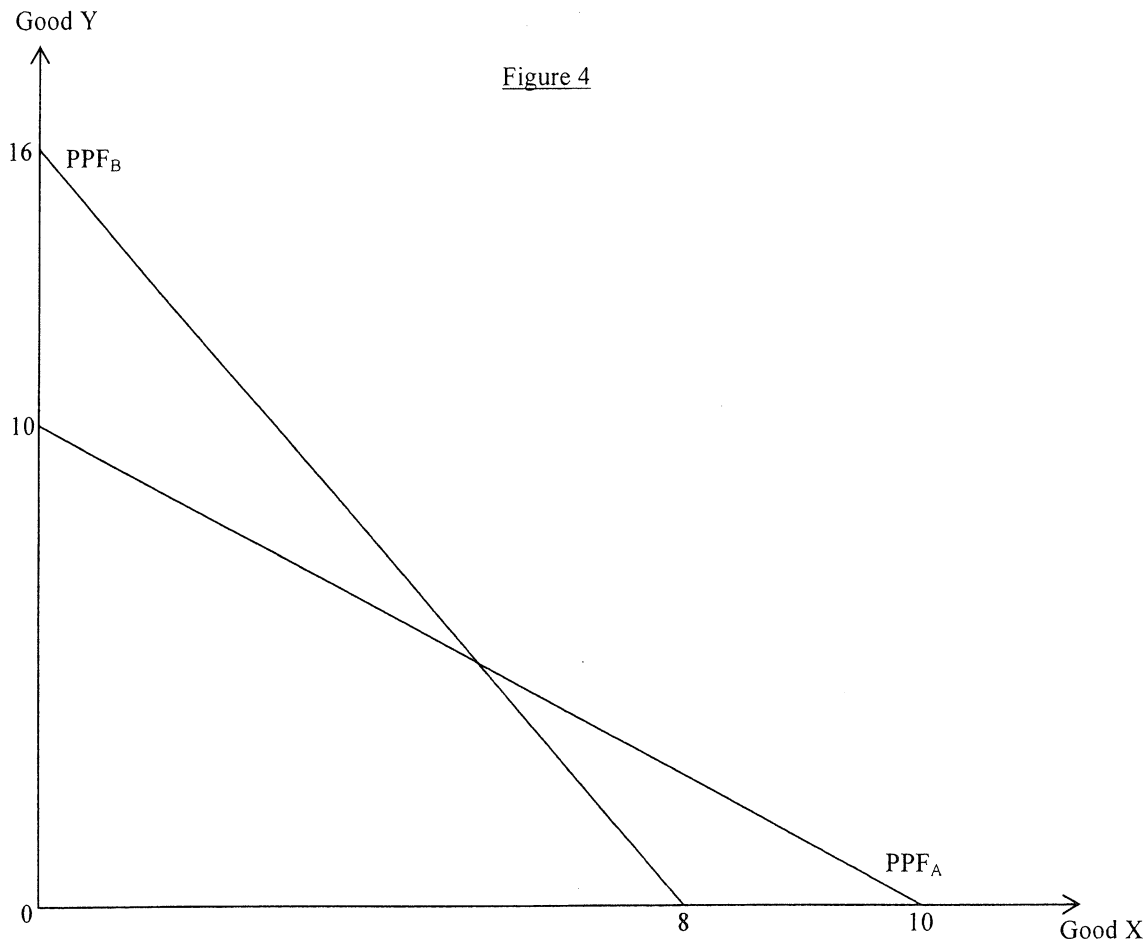
Big Sale for Fresh Beef
More Purchase, Greater Discount!!
The 2nd pound further 10% off
The 3rd pound further 20% off

- (c) Does the practice in the above advertisement constitute price discrimination? Explain. (3 marks)
- (d) Name the anti-competitive behaviour that each of the following cases may constitute and explain how such behaviour restrains competition.
- (i) Suppose Ng Fung Hong agrees to supply the fresh beef solely to one supermarket chain on condition that the chain does not sell imported frozen beef.
- (ii) Several dominant supermarket chains agree to offer discounts for fresh beef simultaneously. (4 marks)
- (e) Regarding the live cattle market, give ONE justification for introducing the competition policy. (2 marks)

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Elective 2

14. Figure 4 shows the production possibility frontiers (PPF) of Country A and Country B.



Suppose the amount of resources of Country A doubles that of Country B in the production of Good X and Good Y. Both countries allocate their resources evenly in the production of Good X and Good Y.

- (a) Explain why the production possibility frontiers of Country A and Country B are straight lines. (2 marks)
- (b) Explain whether Country A enjoys
- (i) an absolute advantage in producing Good X.
 - (ii) a comparative advantage in producing Good X. (5 marks)
- (c) Suppose the international price of a unit of Good X is 1.5 units of Good Y. Show on Figure 4:
- (i) The production point of Country A after specialization.
 - (ii) The consumption possibility frontier (CPF) of Country A when there is trade.
 - (iii) The consumption point of Country A if 4 units of Good X are traded. (5 marks)
- (d) The production possibility frontier of Country A has shifted out due to changes in government policies on human capital. Suggest **TWO** such possible policy changes in Country A. (4 marks)

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