

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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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)

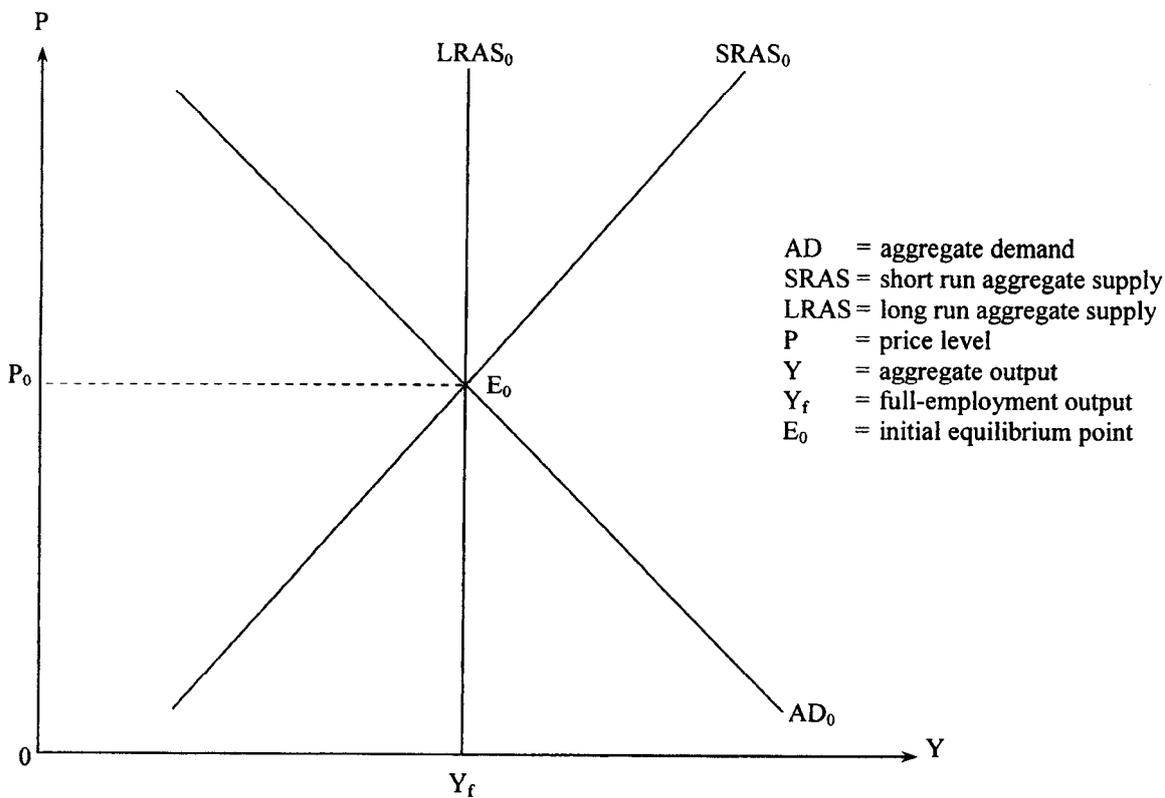


Figure 1

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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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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)

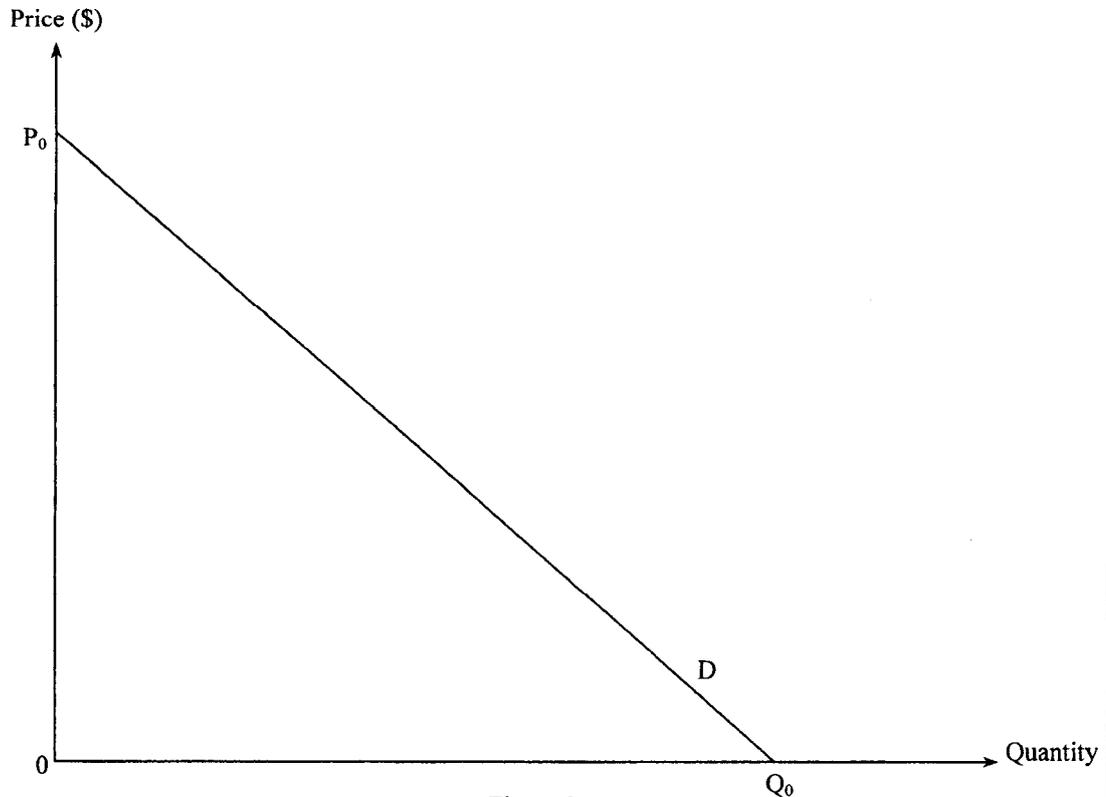


Figure 2

- (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)

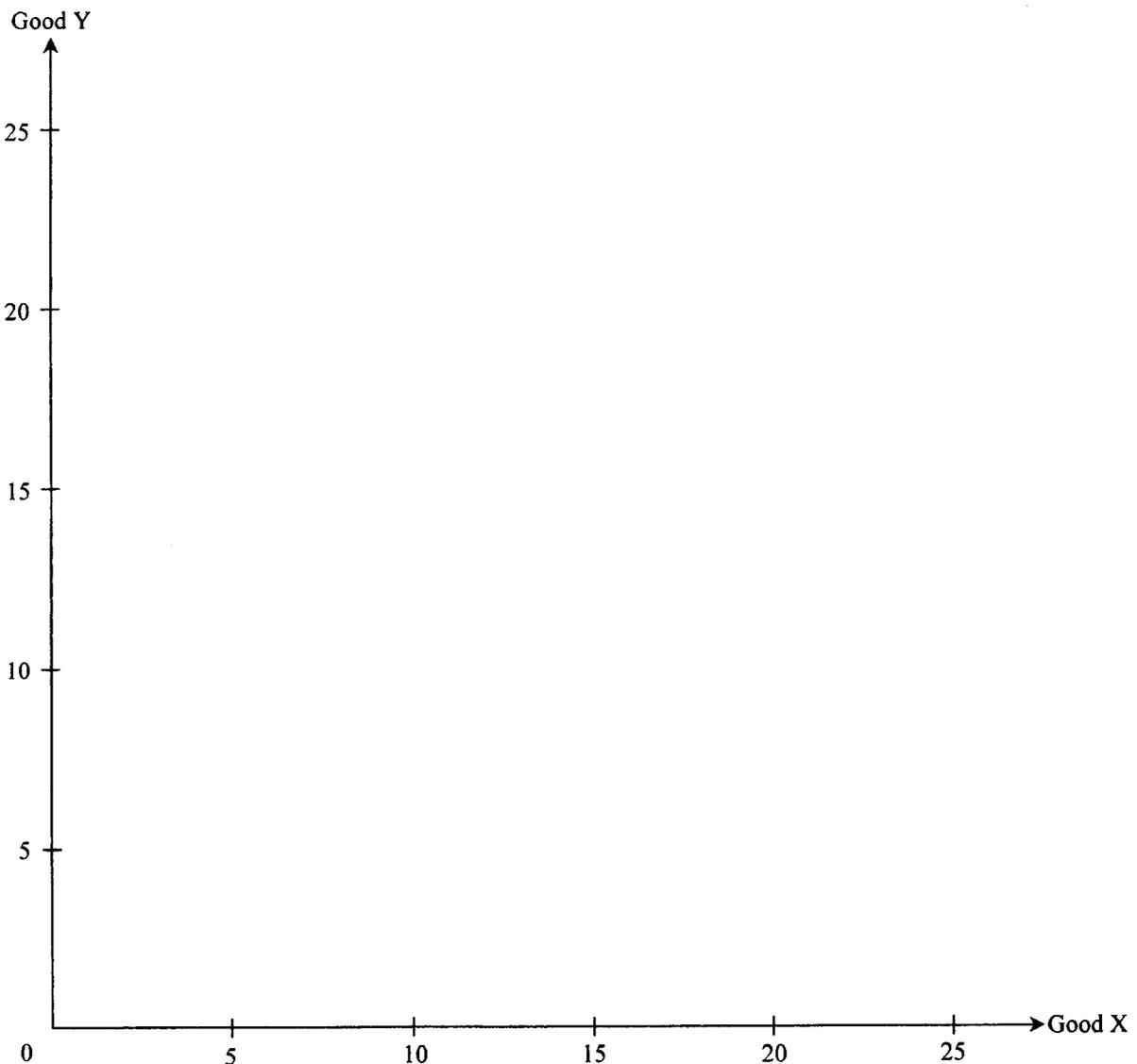


Figure 3

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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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