

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.

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Candidate Number



Section A (50 marks)

1. Serine is working in the Hong Kong branch of a multinational firm. She is considering the next step in her career. She has several options and her order of preference is as follows:

First option:	to work in a firm located in South Korea
Second option:	to switch to a local firm without overtime work
Third option:	to stay in the current firm

Explain whether the opportunity cost of *switching to the local firm without overtime work* will necessarily remain unchanged

- (a) if the military threat from North Korea to South Korea becomes more intense. (2 marks)
- (b) if she wants to enjoy more leisure time. (3 marks)

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2. Steven is a restaurant owner. He pays his waiters a monthly salary and allows them to keep the tips from customers.

- (a) Compared to time rate, explain why the above arrangement is preferred from the viewpoint of
- (i) the employees.
 - (ii) the employer.
- (4 marks)
- (b) Due to the opening of several new branches, the average cost of production of the restaurant has increased. Explain with **TWO** reasons why this happens. (4 marks)

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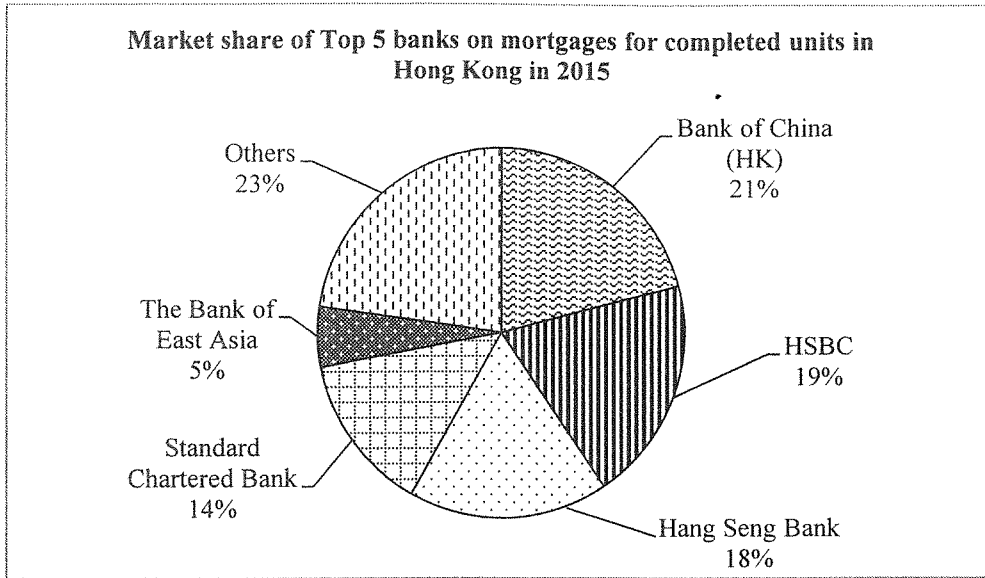
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3. Refer to the following chart.



What was the market structure of the above market in 2015? List **TWO** features of this market structure. (3 marks)

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4. Pokémon Go is a popular game for which gamers need to move around different places with their smartphones to catch the cyber-pets. Its developer has placed hotspots in different areas where many gamers are attracted to gather. Some restaurants in remote areas found their business sharply increased as they are located near these hotspots.

- (a) Based on the above information, explain, in terms of externality, how the placing of the hotspots may result in inefficiency. (3 marks)
- (b) How may such a problem of inefficiency be relieved by market? (2 marks)

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5. Due to political instability, the currency of a country depreciates sharply and becomes highly volatile. Which **TWO** functions of money may be weakened? Explain. (4 marks)

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6. (a) Why can the introduction of a general sales tax stabilise government revenue in times of economic downturn? (2 marks)

(b) Suggest **ONE** type of direct tax in Hong Kong that follows the tax principle of 'equality' put forward by Adam Smith. Explain your answer. (2 marks)

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7. Country A and Country B both allocate half of their resources in producing food and half in producing computers. Their total output is shown below.

	Food (units)	Computer (units)
Country A	100	50
Country B	100	100

(a) Explain whether Country B
 (i) enjoys an absolute advantage in producing computers.
 (ii) will export computers. (5 marks)

(b) Suppose the exchange ratio is 4 units of computer for 7 units of food. Calculate the gain from trade for the computer-exporting country when it exports 16 units of computer. Show your working. (3 marks)

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8. The following table shows the balance sheet of a banking system which has excess reserves of \$250.

Assets (\$)		Liabilities (\$)	
Reserves	1 000	Deposits	3 000
Loans	2 000		

- (a) Find the required reserve ratio. (1 mark)
- (b) Suppose the banks lend out all excess reserves and the public does not hold cash. Calculate the change in deposits after credit creation. Show your working. (2 marks)

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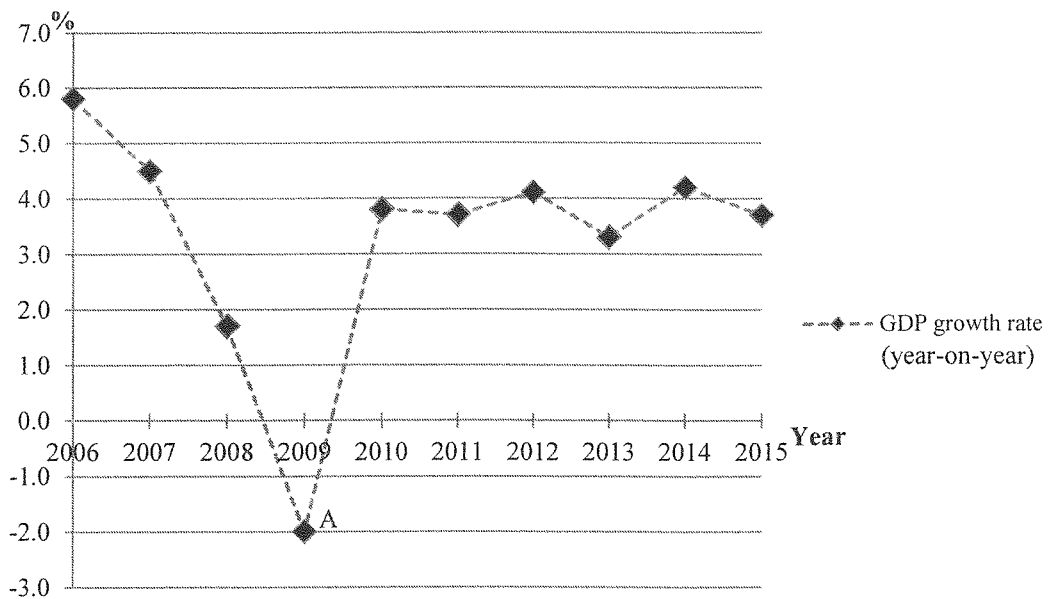
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9. Figures 1 and 2 show some macroeconomic data of the US.

Figure 1: GDP growth rate of the US



- (a) Refer to Figure 1. Identify the phase of business cycle which point A is in. (1 mark)
- (b) How may a reduction in interest rate help the US economy in 2009? Without using a diagram, explain your answer in the light of aggregate supply and/or aggregate demand. (3 marks)

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END OF SECTION A

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Section B (54 marks)

10. MTR Corporation Limited (stock code: 66) provides railway services in Hong Kong.

- (a) MTR is a listed company. State **TWO** differences between such an ownership and a private limited company. (2 marks)
- (b) Some politicians suggest that the government should buy back the shares of MTR so that the company would become wholly owned by the government. Discuss the suggestion by giving **ONE** argument **FOR** and **ONE** argument **AGAINST** it. (4 marks)
- (c) Based on Table 1, can we conclude that 'the increase in total revenue is a result of inelastic demand for the local services of MTR'? Explain your answer with the aid of a diagram. (7 marks)

Table 1: Business information about the local services of MTR

Year	Fare Adjustment Rate	Total Passengers Boarding (in million)	Total Revenue (HK\$ million)
2012	+5.4%	1 431	14 523
2013	+2.7%	1 475	15 166
2014	+3.6%	1 548	16 223

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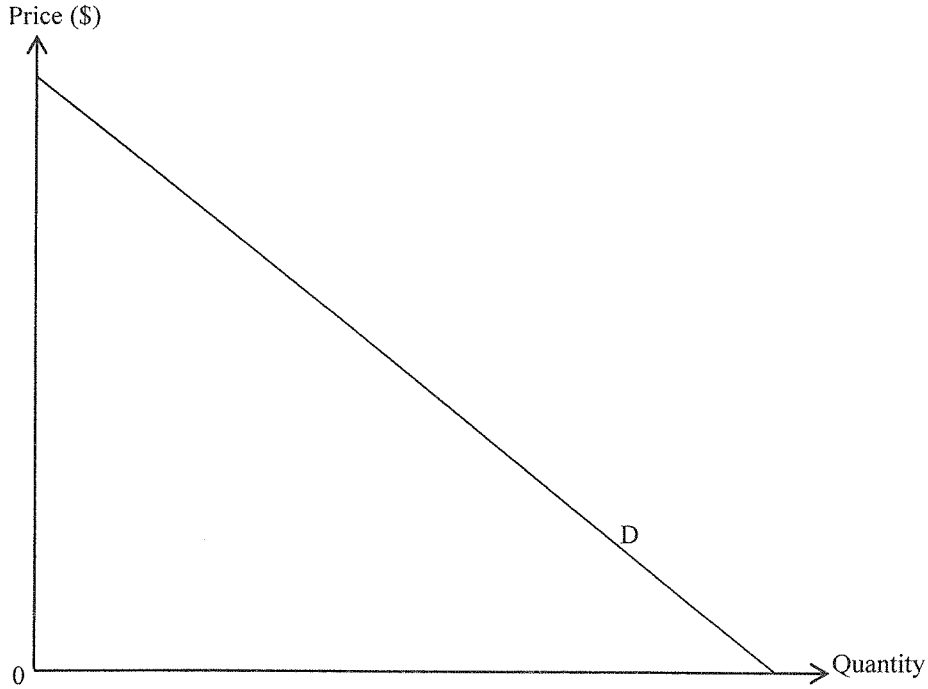
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11. The government of Country X introduces a per-unit subsidy to the education services of private universities.
- (a) Under what condition would the students enjoy a larger share of subsidy benefit than the private universities? Illustrate your answer with the aid of Figure 3. (7 marks)
 - (b) 'The subsidy causes inefficiency even though both students and universities benefit.' Defend the statement by comparing the marginal cost and marginal benefit in Figure 3. (3 marks)
 - (c) Explain whether subsidising education can help improve equality. (3 marks)

Figure 3



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12. Before the British people voted against staying in the European Union (EU), i.e. Brexit, workers from the EU were free to work in Britain and vice versa. Brexit has shocked the economies in Europe and the following table shows some views on Brexit:

<p><i>British politicians:</i> Low-skilled EU workers should be required to apply for a visa to work in Britain.</p>	<p><i>British firm owners:</i> The new visa requirement for EU workers affects most of the firms in the British economy.</p>
<p><i>Global investors:</i> Political uncertainty in Britain increases the risk of investment projects there.</p>	<p><i>EU officials:</i> British citizens may require a visa to visit or to work in the EU countries.</p>

- (a) Referring to the view of the *British politicians*, explain how labour mobility of the low-skilled workers from the EU would be affected. (3 marks)
- (b) Referring to the views of the *British firm owners* and *global investors*, discuss the effect of Brexit on the aggregate output of Britain in the short run with the aid of a diagram. (8 marks)
- (c) Referring to the view of the *EU officials*, which **TWO** components of current account in the balance of payments of Britain may be affected? Explain your answer. (4 marks)

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13. To cope with the problem of a rapidly aging population in Hong Kong, the government has proposed a retirement protection scheme under which eligible elderly would receive \$38 760 per year.

(a) Mr. Chan, a street sleeper, is eligible to receive \$38 760 under this scheme. He would be able to afford the service of an elderly care centre and would spend \$30 000 of the money to pay the yearly charges.

(i) To which type of production does elderly care service belong? (1 mark)

(ii) If Mr. Chan moved to an elderly care centre, explain how the GDP of Hong Kong would be affected. (2 marks)

(b) To finance the scheme, there are different proposals which include:

Proposal A: increase the standard tax rate and the progressivity of salaries tax

Proposal B: use the fiscal reserves in the government

Discuss the effects of these two proposals on economic variables which include

(i) aggregate output,

(ii) income distribution, and

(iii) **ONE** other economic variable.

(10 marks)

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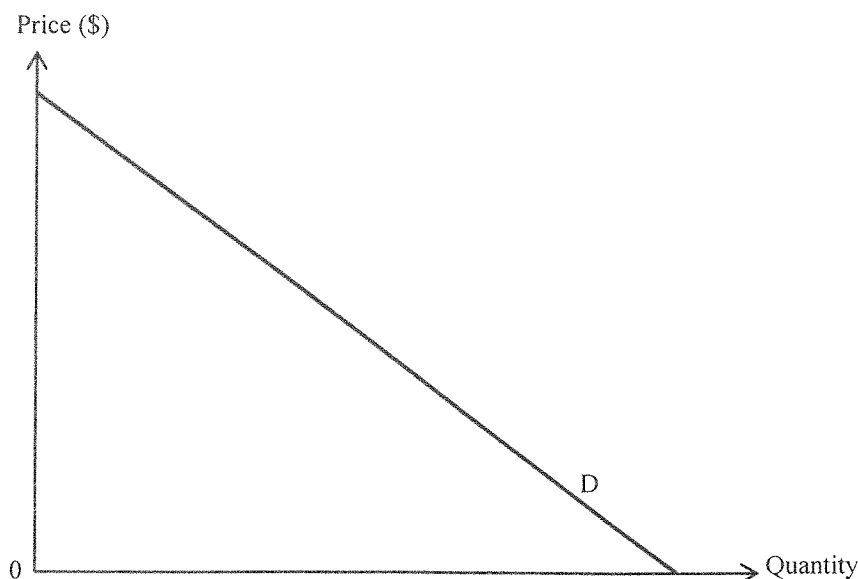
END OF SECTION B

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

14. Suppose HK ONLINE is the only Internet service provider (ISP) in some private housing estates in Hong Kong. Figure 4 shows the demand for this service.

Figure 4



- (a) An economist stated that once the Internet network has been installed, the marginal cost of providing the Internet service would be zero.
- (i) With the aid of Figure 4, explain how HK ONLINE would set a price to maximise its profit under a uniform price arrangement. (4 marks)
 - (ii) Indicate the efficient output level as Q_E in Figure 4. (1 mark)
- (b) Explain whether the following pricing arrangements of HK ONLINE constitute price discrimination.
- (i) Compared to the existing customers, new customers are charged a lower price for the same service plan. (3 marks)
 - (ii) Internet service subscribers pay less for the same service plan if they also subscribe to the TV service from HK ONLINE. (3 marks)
- (c) It is reported that HK ONLINE colludes with other ISPs. Other firms agree to let HK ONLINE be the sole service provider in some private housing estates. In return, HK ONLINE agrees not to compete with these firms in other estates.
- (i) Which anti-competitive behaviour are the firms engaged in? List **TWO** possible motives for the firms. (3 marks)
 - (ii) Which conduct rule of the Competition Ordinance have these ISPs violated in the above case? Explain. (2 marks)

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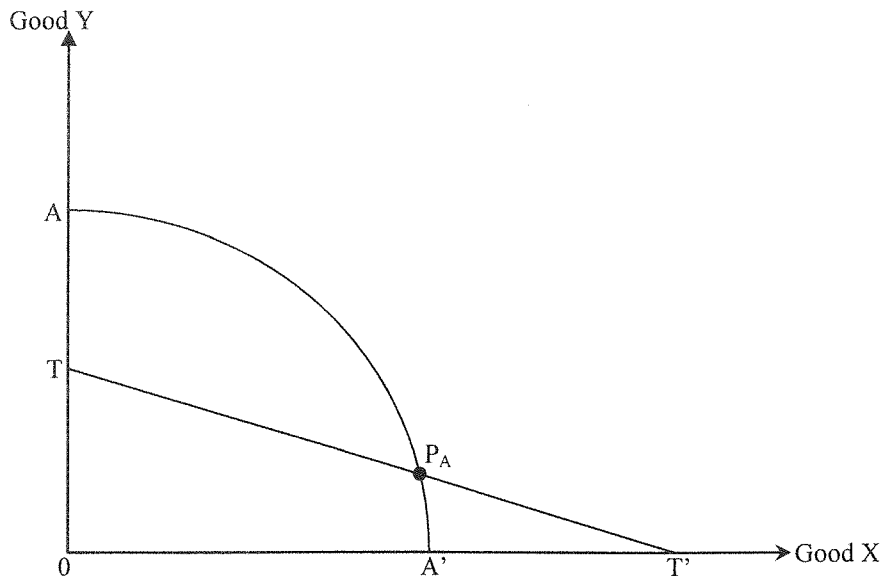
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15. Figure 5 shows the production possibility frontier AA' of Country A. P_A is the production point when there is no trade. TT' is the world price line of Good X.

Figure 5



- (a) Initially Country A did not engage in international trade.
- Indicate the consumption point of Country A as C_A in Figure 5. Explain your answer. (2 marks)
 - Show the opportunity cost of producing Good X in Figure 5. Explain whether Country A would have a comparative advantage in producing Good X. (Hint: you may add a straight line at P_A .) (4 marks)
- (b) Country A opens up to international trade.
- Draw the consumption possibility frontier (CPF) of Country A in Figure 5. Indicate the production point as P_T in Figure 5 and explain your answer in terms of marginal cost. (3 marks)
 - Indicate the consumption point as C_T in Figure 5. Why is Country A better off after trade? (2 marks)
 - Indicate the volume of imports as M in Figure 5. (1 mark)
- (c) The following table shows some data of Country A. Country A opened up to international trade after 2000.

Year	1990	2000	2010
Per-capita real GDP (in US\$)	2 950	3 000	3 600
Human development index (HDI)	0.67	0.68	0.68

With reference to the above table, explain how international trade affects

- the economic growth of Country A. (2 marks)
- the economic development of Country A. (2 marks)

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END OF PAPER

Sources of materials used in this paper will be acknowledged in the booklet *HKDSE 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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