

**ECONOMICS PAPER 2
Question-Answer Book**

10:15 am – 12:45 pm (2 hours 30 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



Please stick the barcode label here.

2. Li Ka Shing Foundation offered an unconditional cash gift of \$5000 to each 2018 HKDSE candidate living in Yuen Long, Tuen Mun and Islands districts under the project ‘Decide Well, Spend Wisely’.

Statement A: The project can improve the public examination results of candidates in those districts.

Statement B: The project can improve equity in Hong Kong.

(a) Explain whether Statement A is a positive statement. (2 marks)

(b) Justify Statement B. (4 marks)

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Please stick the barcode label here.

5. Wong's family and Chan's family live next door to each other. State **ONE** economic concept involved in each of following arrangements and explain why the arrangement is beneficial to both families.

(a) Mr Wong teaches the children from both families English while Mrs Chan teaches them Japanese. (3 marks)

(b) On Christmas Eve, the two families buy food ingredients and cook together instead of buying and cooking separately. (3 marks)

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

6. Study Tables 1 and 2 and answer the following questions.

Table 1: Change in composite consumer price index (CCPI)

| Year 2016 | Year 2017 |
|-----------|-----------|
| +2.3% | +1.7% |

Table 2: Minimum wage rates per hour

| Year 2016 | Year 2017 |
|-----------|-----------|
| \$32.5 | \$34.5 |

- (a) Based on Table 1, state the change in the general price level in 2017. (1 mark)
- (b) On 1 January 2017, Siu Keung expected a +2.3% change of the CCPI in that year, and he lent a sum of money to Kitman at 5% interest rate per annum. On 31 December 2017, Kitman repaid the sum plus the interest to him. With reference to Table 1, explain whether Siu Keung would gain or lose. (3 marks)
- (c) Kitman has been receiving the minimum wage rate per hour. With reference to Tables 1 and 2, explain how her real wage rate would change in 2017. (3 marks)

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Please stick the barcode label here.

7. The following is the balance sheet of a banking system.

| Assets (\$million) | | Liabilities (\$million) | |
|--------------------|-----|-------------------------|-------|
| Reserves | 300 | Deposits | 1 000 |
| Loans | 700 | | |

Suppose the legal reserve ratio is 20% and the public holds \$200 million cash.

- (a) Calculate the excess reserves of the banking system. (1 mark)
- (b) Suppose the public no longer holds cash and all banks lend out all excess reserves. Calculate the maximum possible change in money supply. Show your workings. (4 marks)

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Please stick the barcode label here.

Section B (60 marks)

9. A beauty queen in Hong Kong, Miss Amy Au, is famous for demonstrating the use of cosmetic products with short videos on social media websites. She also sells Japanese cosmetic products on her website.
- (a) Are the short videos on social media websites public goods or private goods? Explain. (3 marks)
- (b) Apart from Japanese cosmetic products, she starts to sell Korean cosmetic products on her website. To what type of expansion does this belong? Give **TWO** possible reasons for this type of expansion. (3 marks)

She plans to hire two staff members to operate her website:

| Personal assistant | Video designer |
|---|--|
| Duties: Arrange daily schedules and meetings | Duties: Produce short videos to be uploaded in social media |
| Salary: \$12000 per month | Salary: \$1000 per video |

- (c) From the viewpoint of Miss Amy Au, suggest **ONE** advantage and **ONE** disadvantage of the payment method of the personal assistant. (2 marks)
- (d) From the viewpoint of the employee, suggest **ONE** advantage and **ONE** disadvantage of the payment method of the video designer. (2 marks)

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Please stick the barcode label here.

10. The following table shows the changes in the individual income tax system in China effective from October 2018.

| Average tax rate | Range of monthly taxable income, in Renminbi (RMB) | |
|------------------|--|-----------------------------|
| | Old brackets | New brackets |
| 3% | Less than or equal to 1 500 | Less than or equal to 3 000 |
| 10% | 1 501 – 4 500 | 3 001 – 12 000 |
| 20% | 4 501 – 9 000 | 12 001 – 25 000 |
| 25% | 9 001 – 35 000 | 25 001 – 35 000 |
| 30% | 35 001 – 55 000 | Unchanged |
| 35% | 55 001 – 80 000 | Unchanged |
| 45% | Greater than 80 000 | Unchanged |

- (a) Is the individual income tax in China progressive, proportional, or regressive? Explain your answer. (2 marks)
- (b) Suppose there is a deflationary (output) gap in China economy. With the aid of an AS-AD diagram, explain how the above change of the individual income tax system would affect the deflationary (output) gap in the short run. (7 marks)
- (c) To achieve the same effect on the deflationary (output) gap as in part (b), an economist suggested the government should lower the required reserve ratio of banks instead of implementing the above change in tax system. Discuss the suggestion by giving **ONE** argument **FOR** and **ONE** argument **AGAINST** it. (4 marks)

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

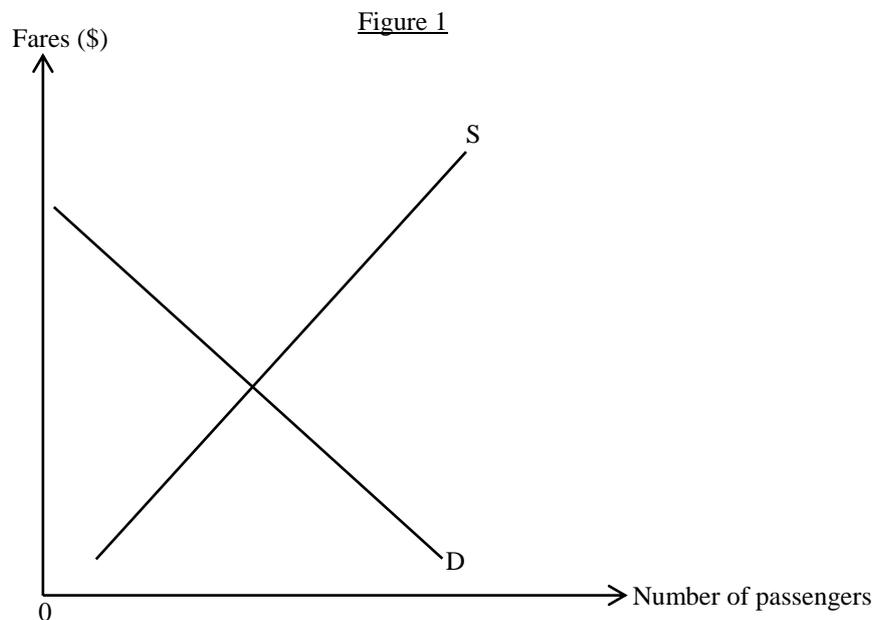
Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

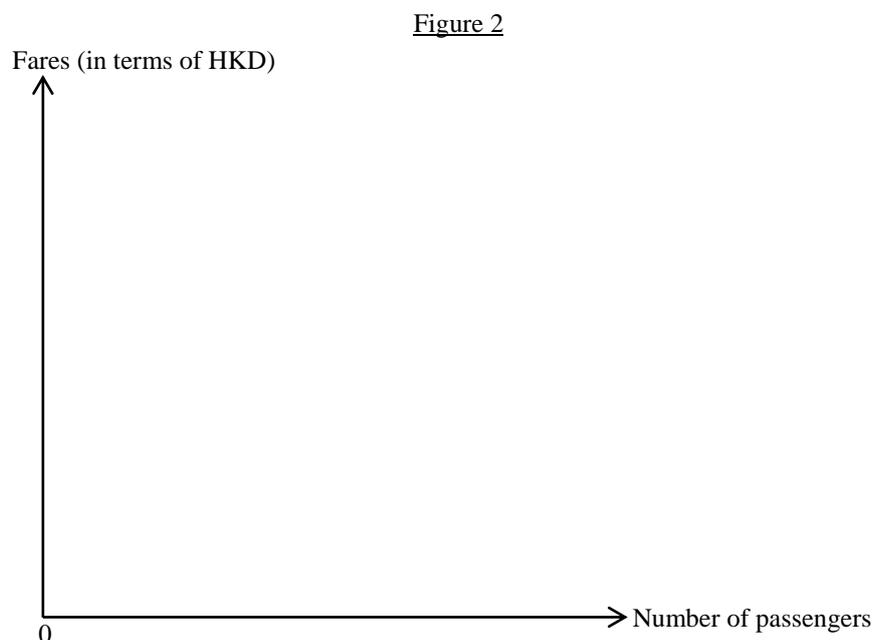
11. The Guangzhou-Shenzhen-Hong Kong Express Rail Link (High Speed Rail) was launched in September 2018.

- (a) Explain the effect of the launch of High Speed Rail on labour mobility of Hong Kong. (3 marks)
- (b) During non-holidays, there are a lot of empty seats on some trains of the High Speed Rail. With the aid of Figure 1, explain why the above situation may be inefficient. (4 marks)



Suppose the fares of the High Speed Rail in terms of RMB are fixed. The fares of High Speed Rail tickets sold in Hong Kong, in terms of Hong Kong dollar (HKD), will be adjusted according to the exchange rate of RMB against HKD.

- (c) ‘A depreciation of RMB against the US dollar (USD) will result in an increase in total revenue (in terms of HKD) of High Speed Rail tickets sold in Hong Kong.’ With the aid of Figure 2, explain under what condition this statement will be correct. (8 marks)



Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

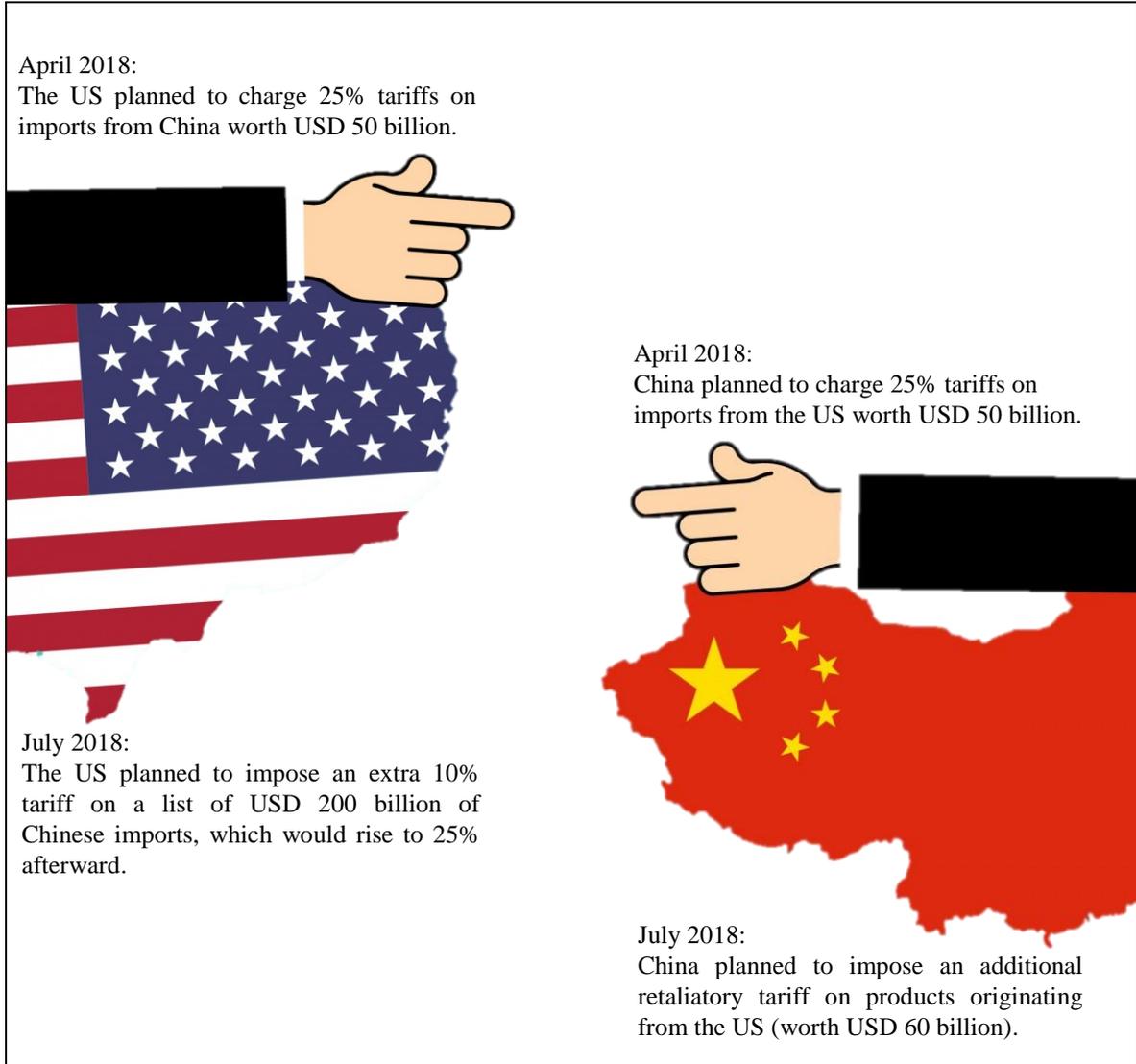
Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

12. A trade war broke out between China and the United States in 2018.

Source A: A graphic showing the major development of the trade war



Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Source B: Statistics of Hong Kong's re-exports of goods

| Re-exports | Value of goods | |
|-----------------------------|----------------------------|--|
| | Overall re-exports in 2017 | Re-exports subject to tariffs under the trade war |
| From the Mainland to the US | HKD 277.5 billion | HKD 136.6 billion (two-round tariffs covering USD 250 billion Chinese products) |
| From the US to the Mainland | HKD 73.2 billion | HKD 11.7 billion (first round tariffs covering USD 50 billion US products) |
| Total | HKD 350.7 billion | |

Answers written in the margins will not be marked.

Source C: An extract of the United States-Hong Kong Policy Act

The US treats Hong Kong separately from China in economic and trade matters.

Source D: Views on the trade war between China and the US

| | |
|--|--|
| <p>A delegate of International Monetary Fund</p>  | <p>People are very worried given the bilateral tension between the world's two largest economies.</p> |
| <p>A Hong Kong trading firm owner</p>  | <p>My business is suffering from a loss because my products exporting to the US are charged by tariff! If the trade war continues, I need to find a way out!</p> |
| <p>An economist</p>  | <p>The trade disputes between China and the US will unavoidably affect the unemployment rate of Hong Kong.</p> |
| <p>An investor in Hong Kong stock market</p>  | <p>Since the start of trade war, the Hang Seng Index has dropped by over 20%. Donald Trump will make me lose a lot of money if he continues to take a hard line on trade with China.</p> |

- (a) Refer to Source A. One of the possible reasons behind the US's imposition of tariffs is to reduce its trade deficits with China.
- (i) Indicate the change in the total market value (net-of-tariff) of Chinese goods exporting to the US during the trade war in a demand-supply diagram. (3 marks)
(Hint: The tariff can be assumed to be per-unit for simplicity.)
- (ii) Explain why the US may **NOT** succeed in reducing its trade deficits with China. (3 marks)
- (b) Refer to Sources B and C. 'Since Hong Kong-produced goods are **NOT** subject to higher tariff during the trade war, the total exports of Hong Kong will **NOT** be affected'. Do you agree with this statement? Explain. (3 marks)

For part (c), candidates are required to present their answers in an essay form. Criteria for marking will include the use of sources and economic theories, relevant content, logical presentation and clarity of expression.

- (c) With reference to the above sources and your own knowledge in Economics, discuss the effects of the trade war on Hong Kong, including:
- aggregate output,
 - tax revenue, and
 - other economic variable(s).

(13 marks)

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

END OF SECTION B

Answers written in the margins will not be marked.

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

13. Grape Limited is the only manufacturer of smartphones in a country. It adopts a uniform pricing.

Figure 3

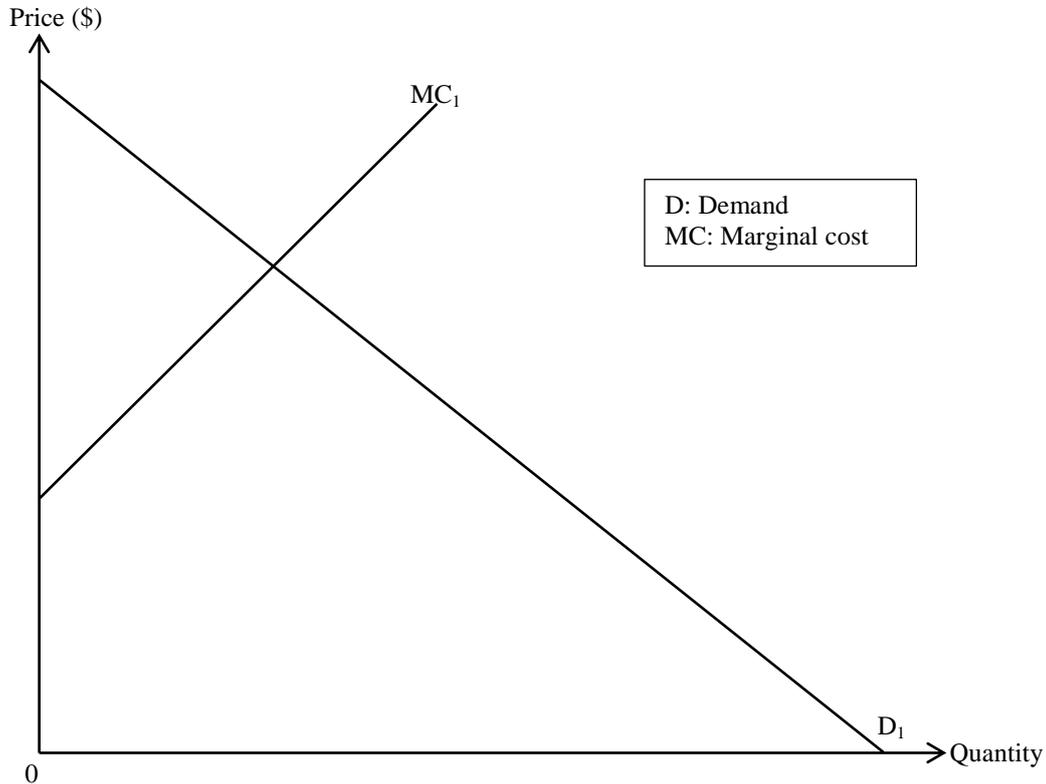


Figure 3 shows the market of Grape Limited's smartphones.

- (a) Explain how the profit maximising output and price are determined. Indicate the output and price as Q_1 and P_1 respectively in Figure 3. (4 marks)
- (b) Technology advance lowers the cost of electronic components of smartphones.
- (i) Indicate the new output and price as Q_2 and P_2 respectively in Figure 3.
- (ii) Discuss the effect of the above change on efficiency with the aid of Figure 3. (5 marks)
- (c) Grape Limited sells its smartphones to students with a 30% discount.
- (i) Explain why this practice will constitute price discrimination.
- (ii) Give **TWO** conditions that this type of price discrimination can be practised. (4 marks)
- (d) A major smartphone operating system provider, Lemon Corporation, requires any smartphone to pre-install its web browser as a condition of licensing for its operating system. Name the anti-competitive behaviour Lemon Corporation engages in. State **TWO** ways in which such kind of behaviour will harm the consumers. (3 marks)

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

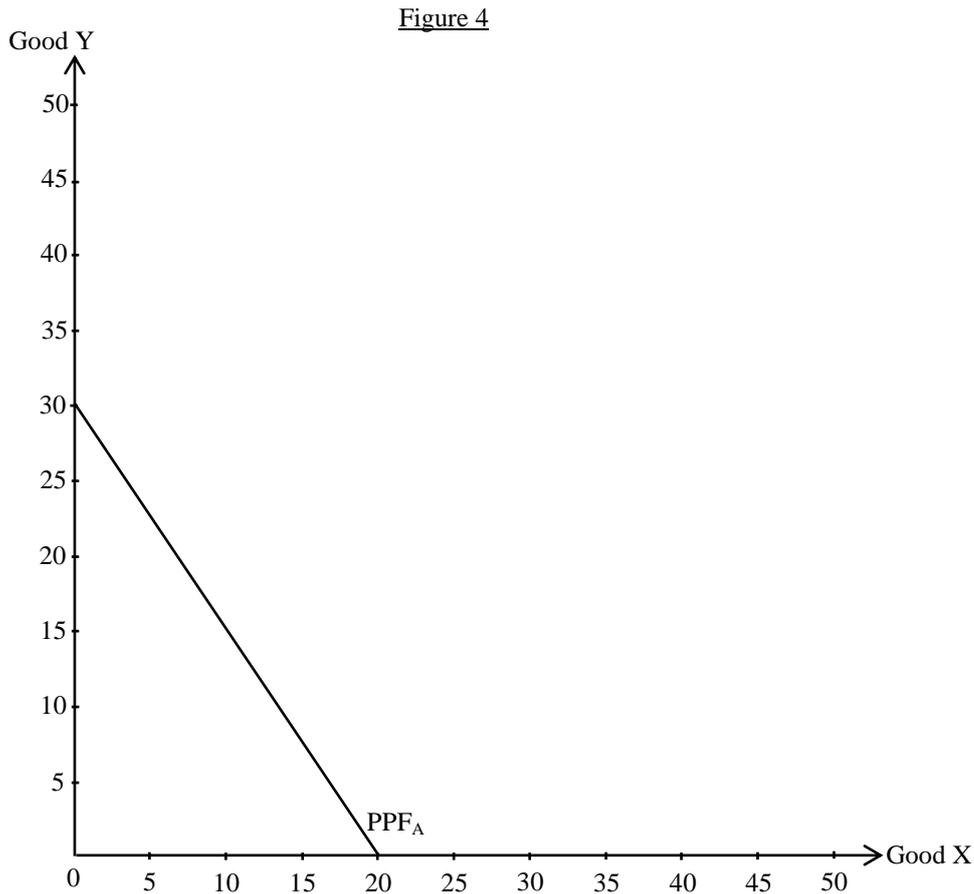
Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

14. Figure 4 shows the production possibilities frontier of Country A (PPF_A).



Suppose initially the world price per unit of Good X is 2 units of Good Y.

- (a) Explain which good Country A will export if it engages in international trade. (2 marks)

Suppose Country A engages in international trade and it always consumes 10 units of Good X.

- (b) With the aid of Figure 4, calculate the total gain from trade of Country A. (5 marks)
- (c) Indicate the volume of exports and imports of Country A in Figure 4. (2 marks)

The world price of Good X falls continuously.

- (d) Explain whether the direction of trade will *necessarily* remain the same. (3 marks)

The leader of Country A decides to adopt a closed-door policy which forbids foreign trade, foreign tourists and foreign workers working in Country A.

- (e) Explain why economic growth in Country A will worsen. (2 marks)
- (f) Other than the reasons about economic growth, explain why economic development in Country A will worsen. (2 marks)

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

END OF PAPER

Sources of materials used in this paper will be acknowledged in the *HKDSE Question Papers* booklet published by the Hong Kong Examinations and Assessment Authority at a later stage.

Answers written in the margins will not be marked.

Supplementary Answer Sheet

Question No. _____

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.