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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.



Section A (50 marks)

- Section A (50 marks)**

1. Apple Inc. launches a new model of smartphone. In order to buy the new model, some people spend hours in trying to login the website of Apple Inc.. If the resale value of the new model falls, the opportunity cost of buying the new model through the website of Apple Inc. will decrease. Do you agree? Explain your answer. (3 marks)

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2. Sure-Star Education Group is a tutorial centre for secondary school students. The Group can issue shares and bonds to the general public to raise capital.

(a) Name the type of business ownership of the Group. (1 mark)

(b) From the viewpoint of owners, explain ONE advantage and ONE disadvantage of issuing shares over bonds. (4 marks)

(c) The average cost of providing the services decreases when the Group operates more tutorial classes in different districts. Give THREE reasons to explain why its average cost decreases. (3 marks)

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3. The table below shows the input-output relationship of a firm.

Machine (units)	Labour (units)	Average output of labour (units)
2	1	10
2	2	12
2	3	14
2	4	14
2	5	13

State the law of diminishing marginal returns and explain whether the above data illustrate the law.

(6 marks)

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4. These years many customers like to take photos of the food they have in restaurants and share them on social media. However, some high-end restaurants do not allow their customers to take photos. Explain how the "photo-taking-and-sharing" behaviour of the customers may involve externality. (3 marks)

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5. Explain, with ONE reason, why the short-run aggregate supply curve is upward-sloping. (3 marks)

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6. Below are the employment data of a country.

Employed population	3 800 000
Underemployed population	800 000
Unemployed population	200 000

- (a) Calculate the unemployment rate of the country. (2 marks)
- (b) Suggest THREE losses to the society caused by unemployment. (3 marks)
- (c) Suppose the country is in the phase of recovery. Apart from the reduction in unemployment rate, give TWO general economic phenomena during recovery. (2 marks)

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7. The input requirements in the production of one unit of clothing and one unit of toys are 6 units and 2 units respectively in Country A. Country A and Country B trade at an exchange ratio of 2 units of clothing to 11 units of toys.

- (a) Which good would Country A export? Explain. (3 marks)
- (b) Suppose a transportation cost of 2 units of toys is required to exchange for 1 unit of clothing and the cost is borne by Country A. Calculate the gain per unit of export for Country A. (3 marks)

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

Assets (\$million)		Liabilities (\$million)	
Reserves	1 000	Deposits	4 000
Loans	3 000		

Suppose the public always holds \$500 million of cash and the banking system does not hold excess reserves.

- (a) Calculate the monetary base and money supply. (2 marks)

The central bank increases the required reserve ratio to 50%.

- (b) Calculate the change in monetary base and the change in money supply. Show your working. (4 marks)

- (c) (i) Why is money supply often a few times more than monetary base? (3 marks)
(ii) Under what situation will money supply be equal to monetary base? (1 mark)

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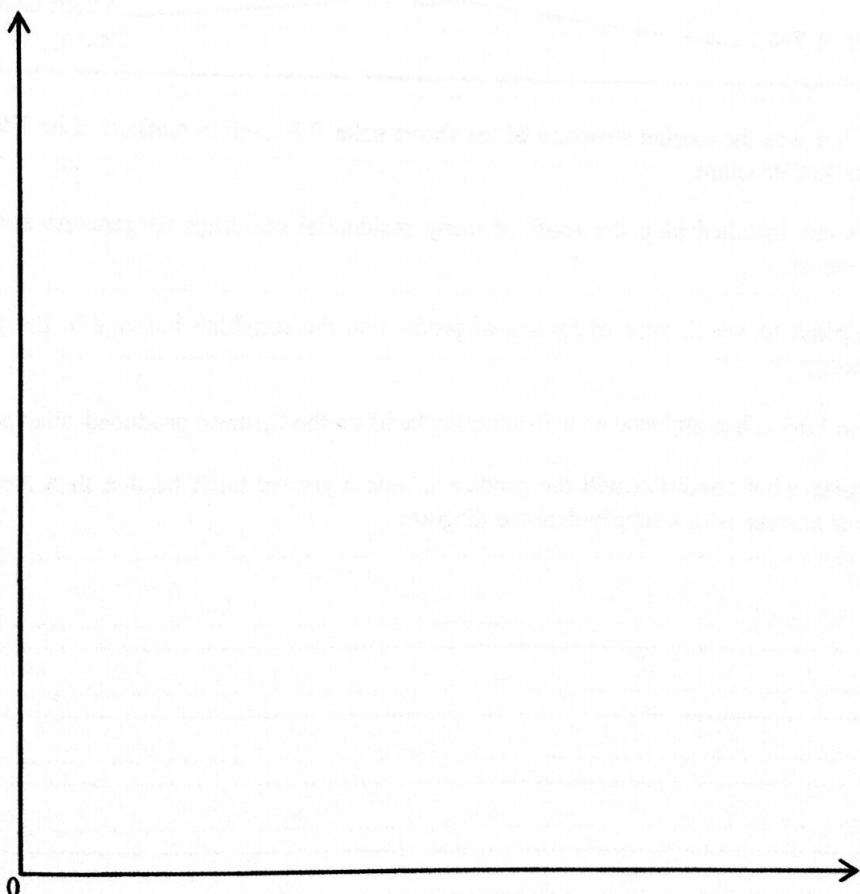
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9. Thousands of farmers of the European Union held street protests to urge the government to support the price of their dairy products which were affected by the following events.

- The European Union abolished the effective quota on the production of dairy products.
- Russia imposed an embargo on the import of dairy products from the European Union.

Use ONE supply-demand diagram to illustrate the effect of the above two events on the price of the dairy products of the European Union. (4 marks)



END OF SECTION A

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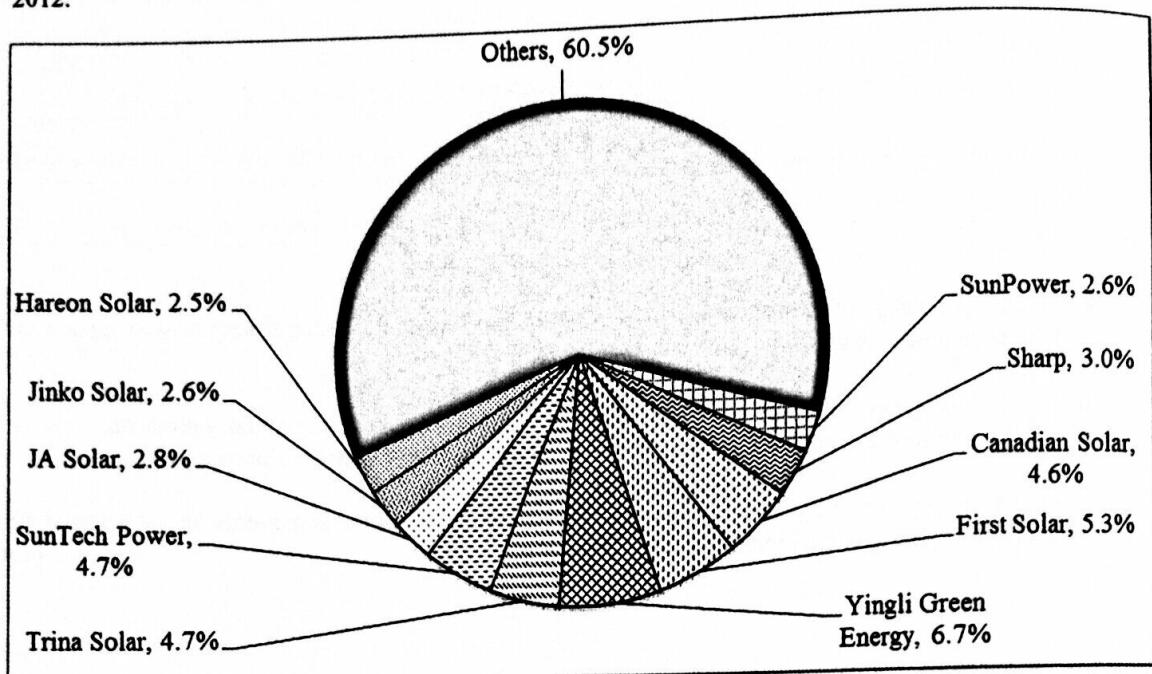
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Section B (54 marks)

10. Solar energy becomes an increasingly important energy source in the sunny western provinces, like Gansu and Xinjiang, in China.

The diagram below shows the market shares of Top 10 solar photovoltaic (PV) module manufacturers in 2012.



- (a) What was the market structure of the above solar PV module market? List **TWO** features of this market structure. (3 marks)

Solar panels are installed atop the roofs of many residential buildings to generate solar energy in those western provinces.

- (b) Explain to which type of factors of production the sunshine belongs in the production of solar energy. (2 marks)

The European Union has imposed an anti-dumping tariff on the Chinese produced solar panels.

- (c) Under what condition will the producers bear a greater tariff burden than the buyers? Illustrate your answer with a supply-demand diagram. (7 marks)

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11. Medical service is one of the basic human needs.

Source A: a conversation outside a public clinic in Hong Kong

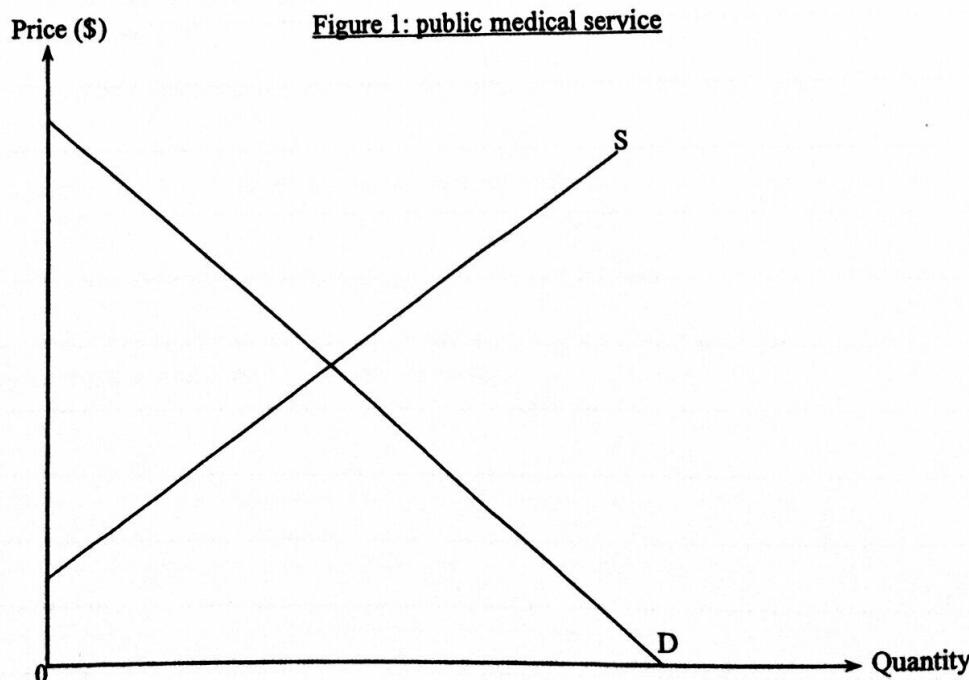
Son: Dad, I feel very ill.
Father: Oh no! There is a long queue waiting.
Son: Why don't we go to a private doctor?
Father: The fee charged by public clinics is only \$45, much lower than that charged by private doctors.

- (a) Refer to Source A. When a public clinic provides medical service for one patient, the resulting rise in gross domestic product will be \$45. Do you agree? Explain. (3 marks)
- (b) With reference to Source A, explain with the aid of Figure 1 how the price set by public clinics may lead to economic inefficiency in the provision of public medical service. (6 marks)
(Assume the supply curve in Figure 1 fully reflects the marginal social cost of public medical service.)

Source B: an extract from the Hospital Authority webpage

The Hospital Authority is committed to providing community-based primary care services. Our target patients include the elderly, low-income individuals, and patients with chronic diseases.

- (c) With reference to Source B, explain how the services provided by the Hospital Authority can enhance equity. (2 marks)
- (d) Many people argue that public clinics should raise the fee to reduce the waiting time. Evaluate this argument in terms of equity and economic efficiency. (4 marks)



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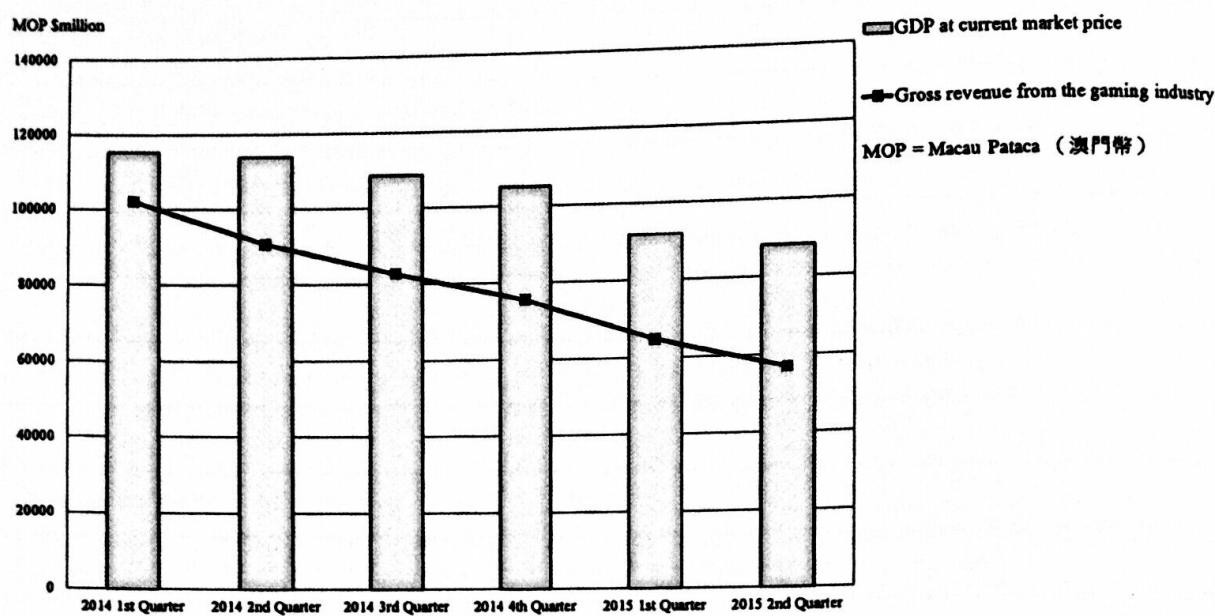
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12. Gaming industry (博彩業) is a major sector in Macau's export of services. The following diagram shows the revenue from the gaming industry and the aggregate output of Macau.



- (a) With reference to the above diagram, describe and explain the trend of the importance of the gaming industry relative to the aggregate output of Macau. (2 marks)

The Macau government implements a cash-sharing scheme, under which every resident receives cash from the government.

- (b) With the aid of an AS-AD diagram, explain how the cash-sharing scheme would affect output and price levels in the short run. (6 marks)

The recent decline in the gaming industry results in a drop in tax revenue. Hence, the government considers reducing its spending on investment but still keeping the cash-sharing scheme. However, an economist suggests that the government should suspend the cash-sharing scheme and allocate the sum of money to investment instead.

- (c) Discuss the suggestion of the economist by giving arguments **FOR** and **AGAINST** it. (5 marks)

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13. The airport corporation of Country H is a public corporation which hires different people to operate the airport. For example, there are security guards, technicians, engineers and financial managers.

(a) What economic principle is illustrated by this practice? Suggest THREE reasons why the application of this principle can increase labour productivity. (4 marks)

(b) The airport corporation plans to build an additional runway. There are two proposals to finance the runway.

Discuss the effects of the two proposals on

- (i) the current account in the balance of payments of Country H, and
 - (ii) the average flight distance for departing travellers of Country H.

(10 marks)

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END OF SECTION B

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Section C (16 marks) Answer any ONE question.

14. Cheung Chau, an outlying island of Hong Kong, is accessible only by ferry. There is only one franchised ferry company providing public transport service between Central and Cheung Chau.

- (a) Suppose the ferry company adopts simple monopoly pricing.

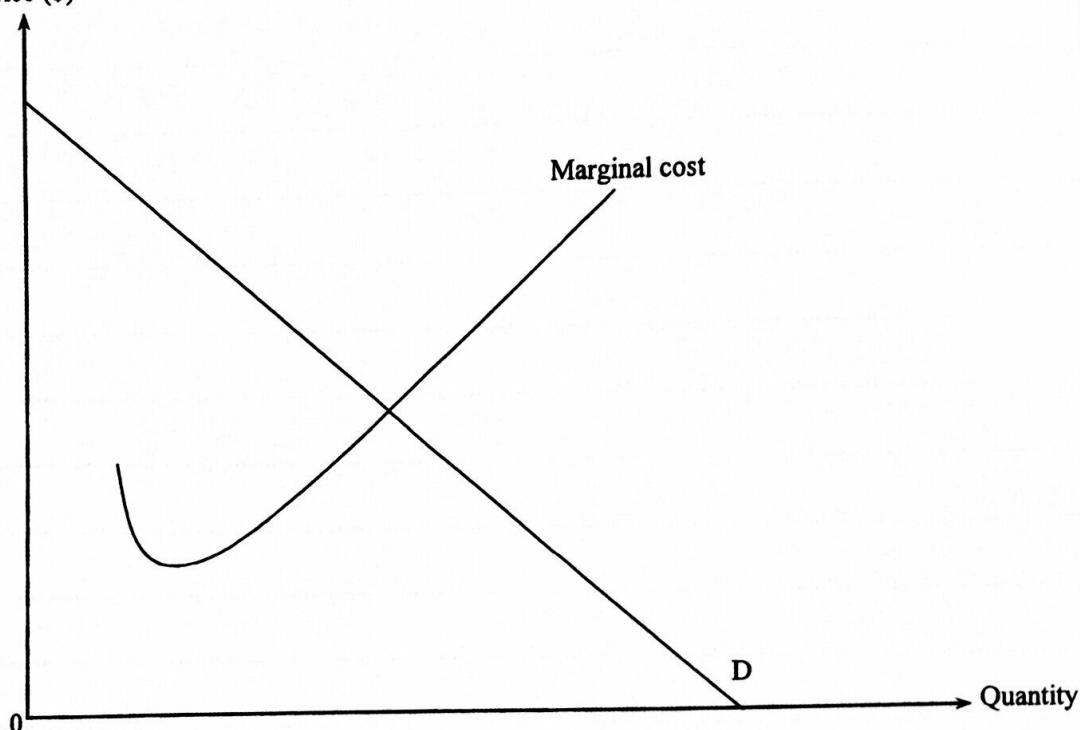
(i) Indicate the output and price as Q_m and P_m respectively in Figure 2. (2 marks)

(ii) With the aid of Figure 2, explain why such a pricing arrangement would lead to a deadweight loss. (2 marks)

Price (\$)

Figure 2

Marginal cost



Quantity

- (b) The fuel price has dropped in recent years.

(i) How would the reduction of fuel price affect the company's marginal cost? (1 mark)

(ii) Suppose the ferry company produces the SAME quantity and charges the SAME price after the fall in fuel price. Explain whether economic efficiency would be affected. Illustrate your answer in Figure 2. (3 marks)

- (c) The table below shows the fare of ferry service from Central to Cheung Chau.

Adult fare	\$13.20
Child fare	\$6.60

Explain whether the above arrangement constitutes price discrimination. (3 marks)

- (d) Many restaurants in Cheung Chau serve seafood dishes. Some of them raise the prices by about 15% on public holidays simultaneously. A student commented, "The restaurants engage in anti-competitive behaviour. They violate a conduct rule under the Competition Ordinance!" His Economics teacher replied, "There may be an alternative explanation for the rise in prices."

(i) Explain under what situation the student's comment may be correct. (3 marks)

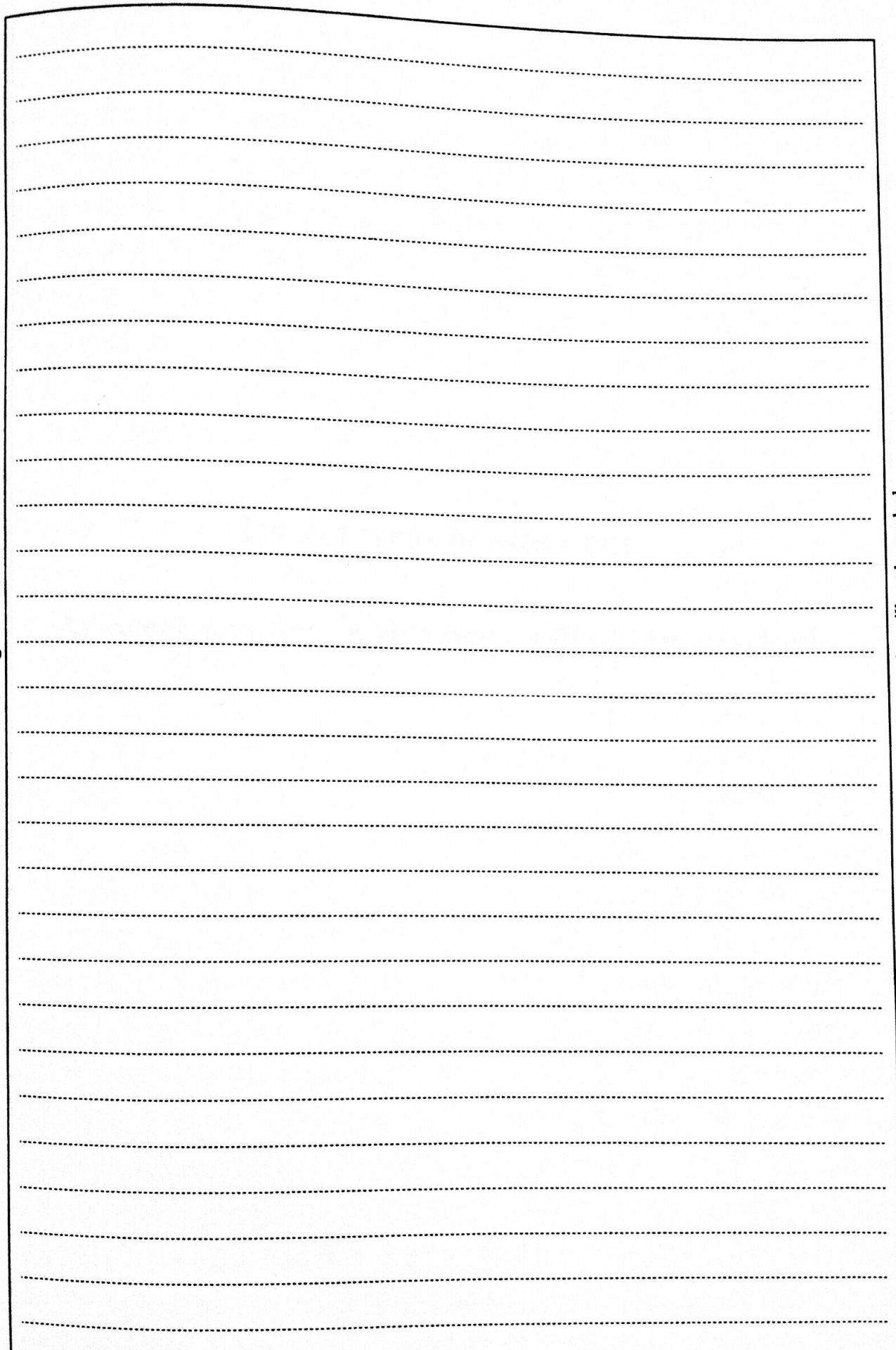
(ii) Give ONE reason to support the teacher's reply. (2 marks)

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15. In Figure 3, MN and TU are the production possibility frontiers of Country A and Country B respectively.

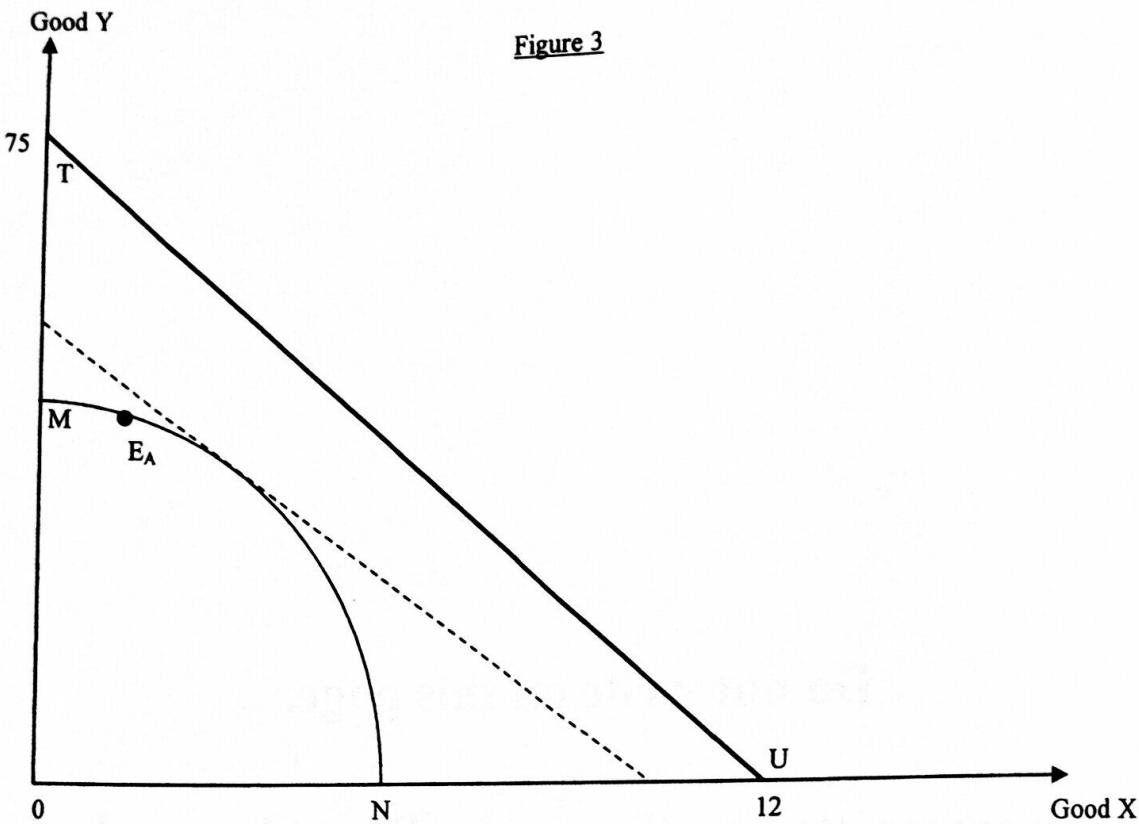


Figure 3

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- (a) Explain why the production possibility frontier of Country A is concave to the origin. (1 mark)

The production point of Country A without trade is E_A , at which the domestic cost of production of 1 unit of Good X is 4 units of Good Y.

- (b) With reference to the domestic cost of production in both countries, explain in which good Country A has a comparative advantage. (3 marks)

Suppose the slope of the dotted line is the world price of Good X.

- (c) Indicate in Figure 3:

(i) the production point of Country A after trade as P_A ,

(ii) the consumption point of Country A as C_A given that Country A consumes the SAME amount of Good X after trade, and

(iii) the volume of import and the volume of export of Country A. (4 marks)

- (d) Country B has a technological improvement which helps double its productivity on Good X and Good Y. Explain whether the answer in part (b) will change. (2 marks)

- (e) The census statistics report of Country A warns that the country would suffer from brain drain, i.e. many residents with a high education level migrate to other countries.

(i) Explain TWO effects of brain drain on the economic growth of Country A. (4 marks)

(ii) In the light of globalisation, suggest ONE policy the government of Country A could adopt to relieve the problem. Briefly explain your answer. (2 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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