HONG KONG EXAMINATIONS AND ASSESSMENT AUTHORITY

HONG KONG DIPLOMA OF SECONDARY EDUCATION EXAMINATION

ECONOMICS PAPER 2
(SAMPLE PAPER)
Question-Answer Book

Duration: 2 hours

This paper must be answered in English

Candidate Number

Question No.	Marker's Use Only — Marker No. — Marks		Examiner's Use Only — Examiner No. — Marks	
1				
2				
3				
4				
5				
6				
7				
8				
9				
10				
11				
12				
13				
Total				

INSTRUCTIONS

(1)   Write your Candidate Number in the space provided on Page 1.

(2)   Stick barcode labels in the spaces provided on Pages 1, 3, 5, 7 and 9.

(3)   This paper consists of three sections, A, B and C.

(4)   Section A contains eight questions.   Attempt **ALL** questions. The whole section carries 50 marks.

(5)   Section B contains three questions.   Attempt **ALL** questions. The whole section carries 54 marks.

(6)   Attempt all questions from any **ONE** of the two electives in Section C. Each elective carries 16 marks.

(7)   All answers should be put in the spaces provided in this question-answer book.   Do not write in the margins. Answers written in the margins will not be marked.

(8)   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 a string INSIDE the question-answer book.

Section A （**50 marks**）

1. The HKSAR government periodically publishes statistics related to the Hong Kong economy. Some of th
    statistics can be viewed free of charge on the internet. Explain whether the statistics on the internet are free
    goods. (3 marks)

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2. Give two reasons for the existence of income inequality in an economy. (4 marks)

Note :   The layout for Paper 2 is different from that in the actual question paper. In the original paper, there is
         enough space for the candidate to write his answer to each question.

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

Worker (Units)	Machine (Units)	Average output per worker (Units)
1	3	400
2	3	450
3	3	500
4	3	450
5	3	400

State the law of diminishing marginal returns and explain whether the above data illustrate the law. (6 marks)

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4.   More customers go to karaoke lounges during the weekends. However, the services are provided at a price higher than on weekdays.

(a)   Why may the fact that customers have more free time during weekends result in a higher market price for the services provided by karaoke lounges?   (4 marks)

(b)   Explain whether customers going to karaoke lounges during weekends incur a higher or lower cost than on weekdays.   (5 marks)

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

Assets ($)		Liabilities ($)	
Reserves	500	Deposits	1 500
Loans	1 000		

(a) Suppose the excess reserves of the banks are $275. What is the required reserve ratio?   (1 mark)

(b) Suppose there is a cash withdrawal of $300 from the banks. Explain whether the banks still have excess reserves immediately after the withdrawal.   (3 marks)

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6. (a) (i) What is the difference between nominal and real interest rates?   (2 marks)

    (ii) Explain under what condition the nominal interest rate would be lower than the real interest rate.   (2 marks)

    (b) Explain why the nominal interest rate is the cost of holding money.   (3 marks)

Answers written in the margins will not be marked.

7. (a) Give two reasons why the aggregate demand curve is downward-sloping. (6 marks)

(b) "Expansionary fiscal policy will have no effect on real income in the long run." Do you agree? Explain. (3 marks)

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8. The national income accounting equation states that $Y = C + I + G + NX$, where Y, C, I, G, and NX stand for national income, consumption, investment, government expenditure, and net exports (i.e. exports minus imports) respectively.

(a) Define national saving as $S = Y - C - G$. Show that $S - I = NX$. (2 marks)

(b) Define national saving as the sum of private and public savings so that $S = S^P + S^G$, where S^P and S^G stand for private saving and public saving respectively.

(i) Explain why the fiscal deficit of an economy would be equal to its trade deficit when $S^P = I$. (3 marks)

(ii) Explain the condition under which an economy could achieve a trade balance when it had a fiscal deficit. (3 marks)

END OF SECTION A

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Section B (54 marks)

9.   The diagram below shows the market demand for and supply of electronic watches. Assume the market electronic watches is perfectly competitive.

Price ($)

Figure 1

0   Quantity of electronic watches
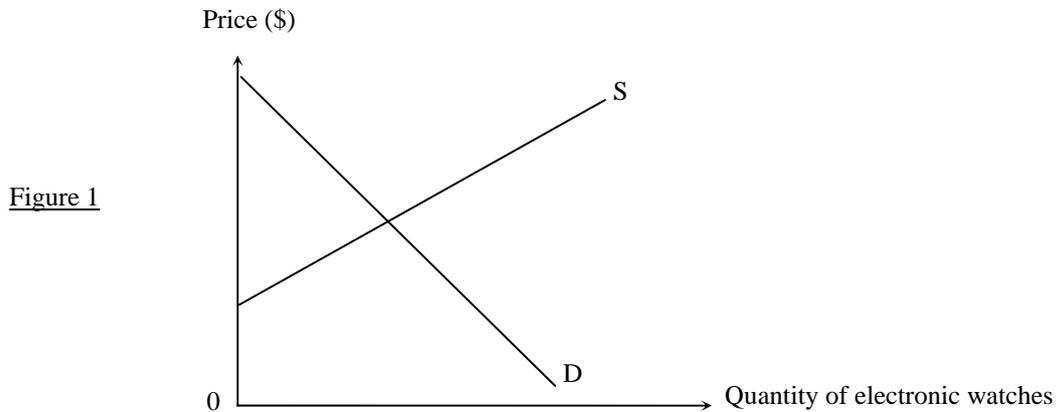
(a)   Indicate the consumer surplus and producer surplus in Figure 1.   (2 marks)

Suppose there is an improvement in technology that lowers the marginal cost of producing electronic watches.

(b)   How would the technological improvement affect the price, quantity transacted, consumer surplus and producer surplus?   (5 marks)

(c)   The schedule below shows the marginal costs of a firm which produces electronic watches before and after the technological improvement.

Output (Units)	Marginal cost ($) before the technological improvement	Marginal cost ($) after the technological improvement
500	70	60
600	80	70
700	90	80
800	100	90
900	110	100

(i)   Is marginal cost a fixed cost or a variable cost? Explain.   (2 marks)

(ii)   Suppose the market price of electronic watches was $80 *before* the technological improvement. What is the output of the firm at this market price?   (1 mark)

(iii)   Suppose the market price of electronic watches fell to $70 *after* the technological improvement. What is the output of the firm at this market price?   (1 mark)

9.   (d)   Patrick is one of the owners of *ABC Electronic Watches Manufacturing Ltd*. He cannot transfer his shares of the company to others in the stock market.

(i)   What kind of business ownership does *ABC Electronic Watches Manufacturing Ltd* belong to? (1 mark)

(ii)   As one of the owners of *ABC Electronic Watches Manufacturing Ltd*, does Patrick need to use his own property to repay the debts of the company if the company goes bankrupt? Explain. (2 marks)

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10.   Many governments in the world face the problem of running a fiscal deficit. Some governments may consider increasing sales tax rates with a view to increasing tax revenue.

(a)   An increase in sales tax rates may reduce firms' willingness to supply goods and services, as well as their willingness to invest. With the aid of a diagram, explain how an increase in sales tax rates would affect the price level and the output of an economy in the short run. (10 marks)

(b)   (i)   Do you think central banks *could* stabilize the price level through monetary policy after the increase in sales tax rates? What would be the effect of such policies on output? Explain. (8 marks)

(ii)   Based on your answer to (b)(i), do you think central banks *should* stabilize the price level through monetary policy after the increase in sales tax rates? Explain. (4 marks)

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11. Some Hong Kong politicians have demanded for the introduction of a minimum wage law for low earners, such as security guards and cleaning workers.

(a) Consider an industry in which the market wage rate is at its equilibrium. With the aid of a diagram, explain how the introduction of an effective minimum wage would affect

    (i)   the number of workers employed in that industry.   (4 marks)

    (ii)   the total wage earnings of the workers in that industry.   (7 marks)

(b) "A minimum wage should be introduced to protect the interests of low-income workers." Evaluate this proposal.   (7 marks)

END OF SECTION B

Section C (16 marks)

Elective 1

12. Mobile phone services in Hong Kong are dominated by several providers. It is said that there is a lack of competition in the market and some of the practices of these service providers are anti-competitive in nature.

    (a) Mobile phone service providers in Hong Kong offer various plans with different charges to their customers. Each plan includes a certain amount of airtime and additional services such as voice mail, call forwarding, free intra network SMS, etc. Usually, the per-minute charges for plans with more airtime are lower than those with less airtime.

        (i) What is price discrimination? (2 marks)

        (ii) State **TWO** conditions for practising price discrimination. Do the mobile phone service providers in Hong Kong meet those conditions? (4 marks)

        (iii) Consider that, apart from the amount of airtime, a certain service provider offers the same additional services to all customers. Is this pricing practice (charging a lower per-minute price for plans with more airtime) an example of price discrimination? Explain your answer. (4 marks)

    (b) In early 2000, all mobile phone service providers in Hong Kong announced an increase of $20 in the monthly charges at almost the same time.

        (i) Explain why all sellers in a competitive market would charge a higher price when there is an increase in the cost of production. (2 marks)

        (ii) Based on the answer to (b)(i), can we conclude that sellers' behaviour in raising prices at the same time in a market is necessarily anti-competitive? What other evidence would be necessary to draw such a conclusion? Explain. (4 marks)

Elective 2

13. Figure 2 shows the production of Country X. AA' and point P are the production possibilities frontier and the production point without trade respectively.

Figure 2

Food

A   P

0

A'
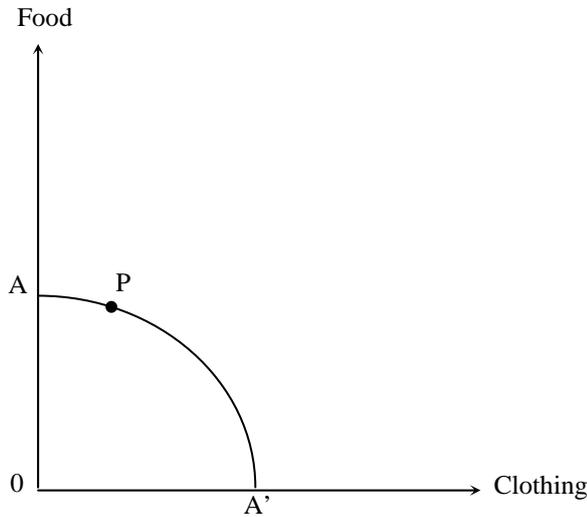
Clothing

Suppose the slope of the production possibility frontier at point P is 0.5 and the terms of trade is 1.

(a) Without trade, what is the marginal cost of producing clothing for Country X?   (1 mark)

(b) In the production of which good does country X have comparative advantage? Explain your answer.
                                                                                              (3 marks)

(c) Draw on Figure 2 the consumption possibility frontier and production point of Country X when there is trade. Show how Country X can gain from trade.   (4 marks)

(d) Suppose there is a technological advance in the production of both clothing and food in Country X.

   (i)   How will the technological advance affect the production possibility frontier of Country X? In what sense can Country X benefit from such an advance? Illustrate your answer in Figure 2.
                                                                                              (4 marks)

   (ii) Technological advance will usually raise a country's per capita real GDP. In addition to the increase in per capita real GDP, give two factors that need to be considered in measuring a country's level of development. Explain your answer.   (4 marks)

END OF PAPER