Marking Schemes

Paper 1

Question No.	Key	Question No.	Key
1.	C (71)	26.	A (62)
2.	C (63)	27.	D (68)
3.	C (75)	28.	A (55)
4.	D (89)	29.	B (43)
5.	B (41)	30.	A (70)
6.	B (73)	31.	B (52)
7.	B (74)	32.	C (64)
8.	A (88)	33.	A (58)
9.	A (79)	34.	B (20)
10.	D (32)	35.	C (78)
11.	B (47)	36.	A (72)
12.	B (48)	37.	C (59)
13.	C (57)	38.	A (73)
14.	A (69)	39.	B (84)
15.	A (58)	40.	A (66)
16.	C (48)	41.	D (45)
17.	B (45)	42.	C (62)
18.	C (53)	43.	D (54)
19.	C (67)	44.	D (19)
20.	D (88)	45.	D (68)
21.	B (63)		
22.	D (64)		
23.	D (72)		
24.	C (75)		
25.	D (64)		

Note: Figures in brackets indicate the percentages of candidates choosing the correct answers.

These documents were prepared for markers' reference. They should not be regarded as sets of model answers. Candidates and teachers who were not involved in the marking process are advised to interpret their contents with care.

The answers provided in the marking scheme are for reference only. They are not the only possible answers. Alternative answers are acceptable so long as they are well reasoned.

The examination emphasises the testing of the understanding of economic theories and the application of the knowledge of economic analysis to practical problems. Candidates are advised to study this document in conjunction with the examiner's comments on candidates' performance in this booklet.

For essay-type questions, candidates are expected to demonstrate an understanding of the question, an ability to deploy relevant knowledge of the subject in response to the questions, and to present their answers logically and coherently.

In questions asking for a specified number of reasons or examples etc. and a candidate gives more than the required number, the extra answers should not be marked. For instance, in a question asking candidates to provide two examples, and if a candidate gives three answers, only the first two should be marked.

The following symbols are used:

/	A single slash indicates an acceptable alternative within an answer.
@	The number in front of the symbol indicates the marks for each point.
max	Maximum mark for the question/sub-question

Section A

				Marks
1.	(a)	(i)	No, because it has positive marginal cost of production; **or** because it is produced from scarce resources, which have alternative uses. [1]	(1) (1)
		(ii)	Yes, [2] because a person can download and study the course materials without reducing the availability of those materials to others, i.e., these materials are non-rivalrous in consumption.	(1) (2)
	(b)		No, because the time cost of a person taking MOOC may be higher than the time cost of another person taking on campus course plus the course fee; **or** the former person (MOCC student) may have to spend extra time to access/download the course materials and to communicate with the course instructor or teaching assistant; **or** the former person may also have to pay for internet connection in order to access the course materials.	(1) (2)

			Marks
2.	(a)	Tertiary production as it provides retail services.	(1) (1)
	(b)	Reasons: – reduce cost of marketing and promotion – reduce transportation cost for suppliers – more related businesses available such as accessories and repair – any other relevant point [Mark the FIRST TWO points only.]	@2 max: 4

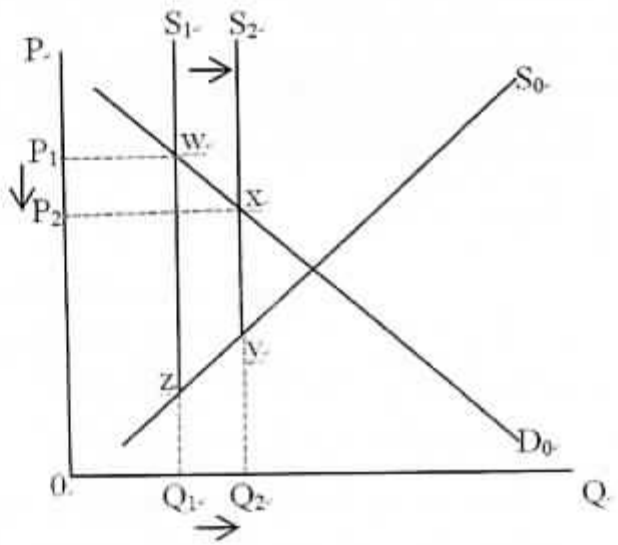
[1] Or because it has positive marginal use value (MUV).
[2] The answer can be "No" if there exist network capacity constraints (or congestion problems) in downloading the course materials.

Marks

3. Agree. (1)

Verbal elaboration:
The increase in effective quota would raise the supply and thus raise the quantity transacted and reduce the price. (1)
The gap between marginal benefit and marginal cost is reduced as the quantity produced is increased toward its efficient level. (1)

Indicate on the diagram:
- Rightward shift of the supply curve corresponding to an increase in quota (1)
- A reduction in P and a rise in Q (1)
- Correct position for the reduction in deadweight loss (area wxyz) (1)



Marks

4 (a) Functions of price:
- Higher prices of small-sized flats would induce real-estate developers to direct more resources towards the production of small flats. [allocative function]
- Prices help transmit information about consumer demand relative to producer supply. [signal function]

@2 max: 2

[Mark the FIRST point only.]

(b) The supply of large flats would drop (1)
as small flats and large flats are in competitive supply.[3] (1)

[3] Assuming the absence of differential land-use restrictions for flats of different sizes.

5. Unemployment rate = (number of unemployed / total labour force) x 100% **Marks** (4)
Since both total labour force and number of unemployed drop by an equal amount, the percentage decrease in the unemployed population is greater than the percentage decrease in the total labour force, implying a reduction in the unemployment rate.

6. (a) (i) Legal Reserve ratio = \$1000 million / \$5000 million = 0.2 **Marks** (1)

(ii) Money supply = \$150 million + \$5000 million = \$5150 million (2)

(b) New monetary base = \$150 million + \$1050 million = \$1200 million (2)

(c) New money supply= \$150 million + \$1050 million/0.2 = \$5400 million (3)

7. (a) Uncertain. Since the amount of resources owned by the two countries is not given, their productivities (i.e., output-input ratios) cannot be determined and compared. **Marks** (2)

(b) In Country A, the opportunity cost in producing 1 unit of clothing (C) in terms of rice (R) = 15/3 = 5 units of rice (R). (1)
In Country B, the opportunity cost in producing 1 unit of clothing (C) in terms of rice (R) = 8/4 = 2 units of rice (R). (1)
Therefore Country A (B) enjoys comparative advantage in producing rice (clothing).

Per unit gain from trade for Country B = 4R – 2R = 2R
Total gain from trade = (4R–2R)×3 = 6R
OR
In other words, Country B would be the clothing-exporting country, producing 4C, exporting 3C in exchange for 12R and keeping 1C for domestic consumption. Without trade, it could have produced 1C and 6R on its own. Its total gain from trade is thus 6R (= 12R–6R).[4]

} either one; max: 2

[4] Using knowledge learned in Elective 2, candidates may reach different answers depending on their assumptions about the initial, before-trade production point. (Actually, information about preferences of Country B's consumers is required to determine its autarky equilibrium, hence gains from trade.) Suppose, without trade, Country B would produce R_B units of rice and C_B units of clothing. Its total gains from trade are thus $(12–R_B)$ units of rice plus $(1–C_B)$ units of clothing. Given that the terms of trade (TOT) equal 4(=12/3) units of rice per unit clothing, these gains amount to $(12–R_B)/4+(1–C_B)$ units of clothing **or** $(12–R_B)+(1–C_B)\times4$ units of rice.

Marks

8. Proposal 1:

- Equalizing opportunities:
  Free education for longer years means that the poor are able to receive more education and improve their productivity and hence income-earning power in the future.
- Other things equal, more money spent on education would increase government expenditure, leading to an increase in aggregate demand and thus aggregate output. [Demand effect]
- Free education for longer years would improve labour productivity and thus aggregate output over time. [Supply effect]
- Provision of free education beyond normal school age would reduce labour supply (by keeping more people at school) and thus aggregate output in the current period. [Cost of investment in human capital]
- Any other relevant point

@2; max: 4

Proposal 2:

- Equalizing income/outcome:
  More welfare payments to the unemployed could help reduce the income inequality between the employed (rich) and the unemployed (poor).[5]
- Unemployment benefits would increase the disposable income and consumption of the jobless, and thus aggregate demand, resulting in a rise in aggregate output. [Demand effect]
- Unemployment benefits may, however, produce disincentive effects on labour supply, resulting in de-skilling of labour (i.e., decumulation of human capital) and a drop in aggregate output now and in the future. [Supply effect]
- Any other relevant point

@2; max: 4

[5] But this may NOT serve to narrow the income gap between the rich and the poor in the case of high-skill unemployment.

Section B

		Marks
9. (a)	Advantage: – Lower risk of being taken over – No need to disclose accounting information to the public – Any other relevant point [Mark the FIRST point only.]	@1 max: 1
	Disadvantage: – Owners cannot freely transfer their stocks – The firm cannot raise capital by issuing stocks to the general public – Any other relevant point [Mark the FIRST point only.]	@1 max: 1
(b)	Lateral expansion, as fast food and coffee are related but not directly competitive products.	(1) (1)
(c)	Possible reasons: – Lower-quality coffee – Lower production cost – Less pleasant environment – Less attractive brand name – Any other relevant point [Mark the FIRST TWO point only.]	@2 max: 4
(d)	No,[6] – because it is not sold to the market and thus not counted in production [Output Approach] – because it is neither counted in consumption nor investment [Expenditure Approach]	(1) @1 max: 1

[6] Or because business losses due to destroyed products (i.e., negative profits) would offset exactly wages paid to workers and other material costs incurred in producing these products (i.e., positive wage and other factor incomes). [Income Approach]

Marks

10 (a) (i) HK's GDP would increase (by $3 million). As the course is a current-year production by a resident production unit, its value would be included in GDP. (2)

(ii) HK's GNP would decrease (by $5 million), as change in GNP = change in GDP (+$3 million) + change in net income from abroad (–$8 million). As the Brazilian coach is NOT a HK resident, the $8 million he received would be counted as income outflow and enter as a negative item in HK's national income account. (3)

(b) Advantage of Contract B over Contract A:

- The owner of the football team can share some business risks with Player B as the former would make less payment to the latter when no match is played and/or no goal is scored
- The owner of the football team can have a lower cost of monitoring players's performance as Player B would have a higher work incentive in training and in matches
- Any other relevant point

[Mark the FIRST TWO point only.]

} @2 max: 4

(c) Professional football players have low occupational mobility, (2)
as their skills are very specific and not easily transferable to other jobs. (1)

Marks

11 (a) (i) The percentage change in direct tax revenue and percentage change in nominal GDP tend to move in the same direction. Fluctuation of the former is greater than that of the latter. (2)

(ii) Direct taxes in the form of income taxes (such as taxes on salaries and profits) are highly affected by the macroeconomic situation. Growth in the economy (increases in GDP) would be accompanied by growth in salary and profit incomes, which would in turn generate higher revenue from taxes on such incomes. (2)
Progressive taxation may be one explanation for why direct tax revenue fluctuated more than GDP.

(b) Introduction of new types of indirect taxes, such as general sales tax or value-added tax, would make more people or commodities fall into the tax bracket, thus broadening the tax base. (2)

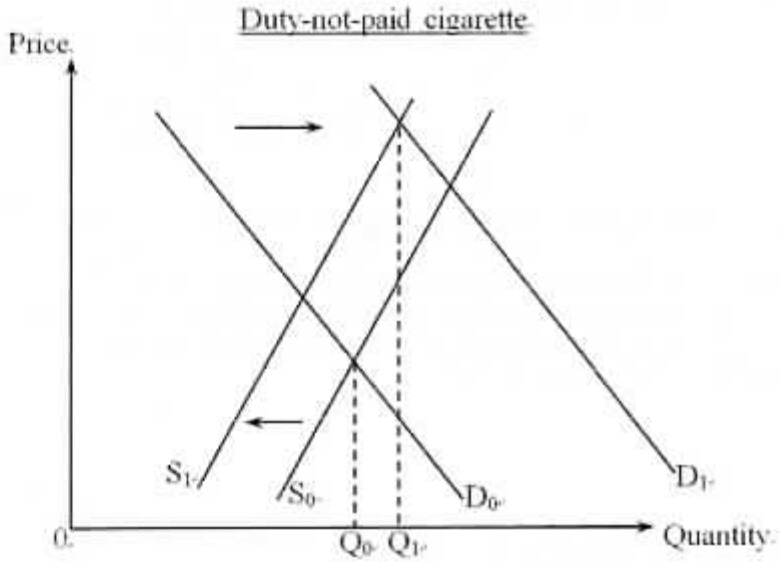
(c) Tobacco duty would increase the market price of duty-paid cigarettes and thus reduce its quantity demanded. (1)
If cigarette consumers are addicted, their demand for cigarettes would be inelastic, so the percentage decrease in quantity demanded would be smaller than the percentage increase in price. In this case, even a huge increase in tobacco duty may not be effective in reducing the consumption of cigarettes. (3)

(d) Verbal elaboration:

On the one hand, due to the HK Customs' crack-down effort, the supply of duty-not-paid cigarettes would drop. On the other hand, as duty-paid cigarettes and duty-not-paid cigarettes are substitutes, tobacco duty would increase the demand for duty-not-paid cigarettes. It is thus possible that the total quantity of duty-not-paid cigarettes sold would increase if the increase in demand has a bigger effect on the quantity transacted than the decrease in supply. (4)

Indicate on the diagram:

- Rightward shift of the demand curve (1)
- Leftward shift of the supply curve (1)
- Final equilibrium with a higher quantity transacted (1)



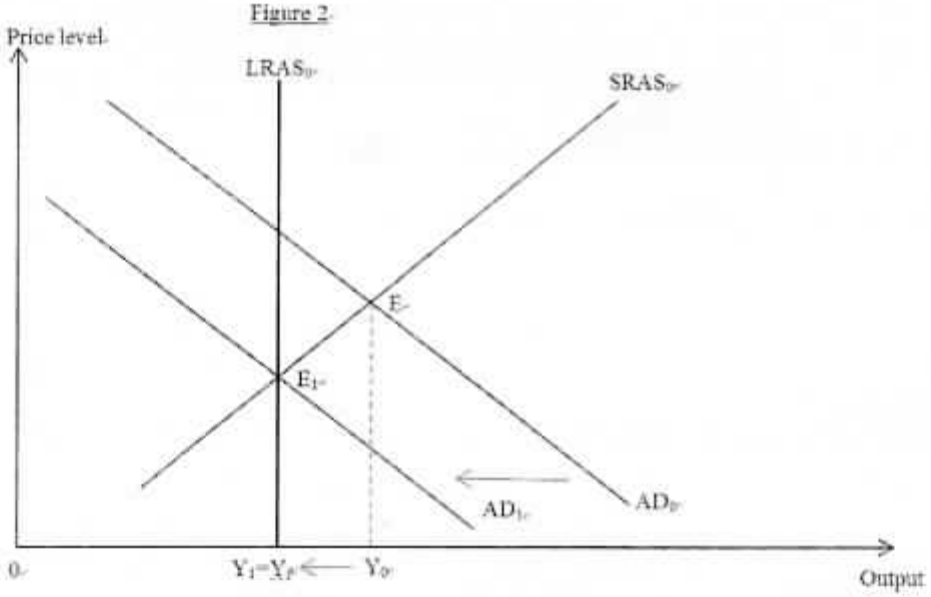
Marks

12. (a) A drop in the export of services to mainland tourists (1)
would reduce HK's current account surplus (or enlarge its deficit). (1)

(b) Verbal elaboration:
Export would fall, (1)
resulting in a drop in aggregate demand, (1)
so output would fall back to Y_f.

Indicate on the diagram:
- AD curve shifts to the left (1)
- Correct position of initial short-run aggregate output Y_0 (1)
- Correct position of new short-run aggregate output Y_1 (=Y_f) (1)

Figure 2



(c) Hong Kong is facing an inflationary gap. There is an excess demand in the factor market, creating pressure for factor prices to adjust upward, so that costs of production would increase over time and short run aggregate supply (SRAS) would fall over time, restoring output to Y_f in the long run. (4)

(d) Negative externality / divergence between private and social costs. (1)
When the public transportation system is overcrowded (i.e., at full capacity), any additional passenger using the system would increase the time cost for other passengers without having to compensate them for this extra cost (implying a divergence between private and social costs). As marginal social cost is now higher than marginal social benefit, the number of passengers using the system would exceed its efficient level. (3)

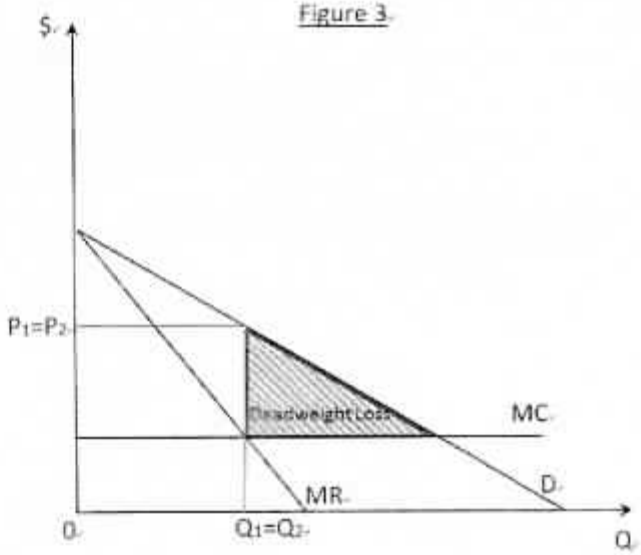
Section C

Marks

13. (a) Verbal elaboration:
Super Power will produce at the output level where Marginal Revenue = Marginal Cost. (1)

Indicate on the diagram:
- Correct position of Q_1 (1)
- Correct position of P_1 (1)

Figure 3



(b) Verbal elaboration:
At Q_1, marginal benefit exceeds marginal cost. (1)

Indicate on the diagram:
- Correct position of deadweight loss (1)

(c) (i) No. Since the lump sum tax is a fixed cost, which does not vary as output changes, it would not affect marginal cost. (2)

(ii) Indicate on the diagram:
- Correct position of Q_2 (1)
- Correct position of P_2 (1)

(d) Yes. Different groups of customers (domestic users and industrial users) are charged different prices for the same good (power used) produced at the same cost.[7] (3)

(e) Merger. (1)
It restricts the entry of potential competitors. (1)

(f) The merger may reduce the average cost of production by lowering the cost of raw materials/ enjoying economies of scale. If Super Power transfers such benefits to the consumers via a reduction in the price of electricity, the merger may not be anti-competitive. (2)

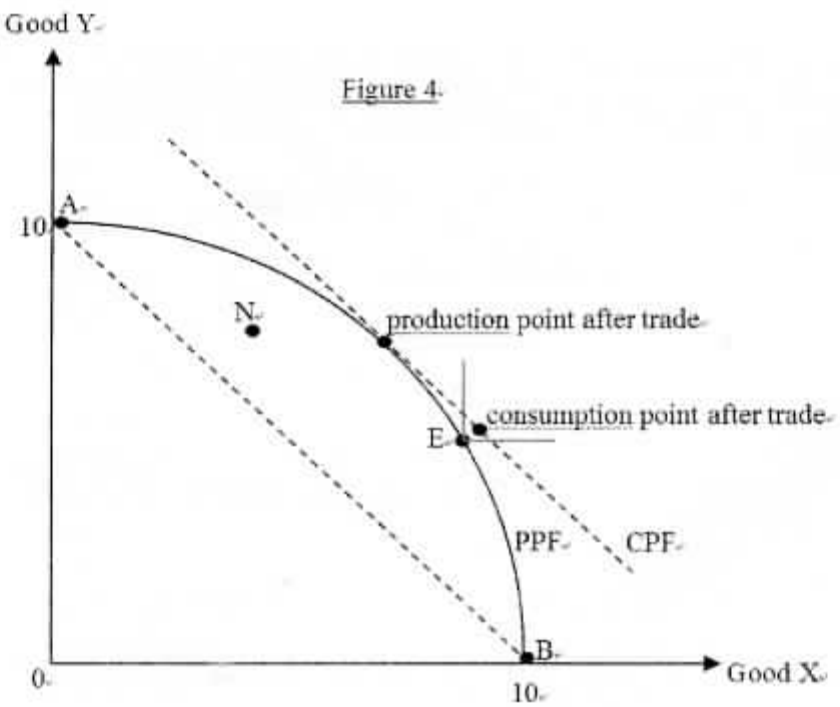
[7] Assuming that the same technology is used to supply power for both domestic and industrial uses.

Marks

14. (a) No, (1)
because there will be idle resources in the country / the country is not maximizing its production.[8] (1)

(b) No (1)
Because, without trade, the domestic cost of good X trade in country A (= 2.5Y) exceeds the world price of X (= 1Y) (2)
OR
Opportunity cost of 1 X = slope of the tangent of PPF at E > slope of AB

(c)



- correct position of production point after trade (1)
- tangency between CPF and PPF (1)
- CPF is parallel to AB (1)

(d) Verbal elaboration:
Yes, because the country can consume beyond its PPF (which is also its CPF without trade) / the country can consume more of X and Y after trade. (2)

Indicate on the diagram:
- Correct position of consumption point after trade (1)

[8] The country may produce at point N if there exists unemployment due to, say, market frictions or structural changes

(e) (i) Reason:

- GDP may increase because of trade-induced transfer of superior technology from its trading partners, resulting in an increase in productivity.
- Exchange in health technology may increase life expectancy.
- Any other relevant point

[Mark the FIRST point only.]

} @1 max: 1

(ii) Reasons:

- Workers in import-substitute industries may suffer unemployment
- Income distribution may become more uneven
- Pollution may increase (due to specialization in producing more "polluted" goods)
- Any other relevant point

[Mark the FIRST TWO point only.]

} @2 max: 4