Marking Schemes

Paper 1

Question No.	Key	Question No.	Key
1.	B (74%)	26.	D (65%)
2.	C (66%)	27.	C (57%)
3.	D (76%)	28.	B (64%)
4.	D (45%)	29.	A (41%)
5.	C (88%)	30.	C (74%)
6.	B (84%)	31.	D (65%)
7.	B (52%)	32.	A (76%)
8.	B (86%)	33.	*
9.	D (49%)	34.	D (34%)
10.	A (94%)	35.	A (57%)
11.	B (72%)	36.	C (61%)
12.	B (76%)	37.	B (65%)
13.	D (64%)	38.	*
14.	A (55%)	39.	A (69%)
15.	A (37%)	40.	C (34%)
16.	B (71%)	41.	B (60%)
17.	A (67%)	42.	C (56%)
18.	D (44%)	43.	B (48%)
19.	A (43%)	44.	A (52%)
20.	B (26%)	45.	D (56%)
21.	C (68%)		
22.	D (61%)		
23.	C (54%)		
24.	D (37%)		
25.	C (48%)		

* This item was deleted.

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

General note on item deletion

It is normal for the HKEAA to delete a small number of items from its multiple-choice question papers if they prove unsatisfactory. In practice, there are a number of reasons why this is considered necessary. By far the most common reason for deleting an item is that the item fails to discriminate between weak and able candidates - in other words, the majority of the candidates involved had to rely on guesswork in answering that question. If such an item is retained, the measurement process is rendered less effective. Where items have been deleted in the live papers, they are still included in this series of publications. They are indicated as deleted items. Such items may be discussed in the corresponding examination reports.

Section A

1. The full cost of buying the new model includes the price of new model (monetary cost) plus the value of time spent logging in the website. The resale value of the new model is not a forgone option so the cost of buying the new model does not change when such value falls. **Marks** (3)

or

The drop in resale value will lower the (speculators') demand—hence, excess demand—for the new model, reducing the time spent logging in the website and thus the time cost of buying the new model. The cost of buying the new model falls. **or** (3)

2. (a) Public limited company/listed company. **Marks** (1)

(b) Advantages:
- no interest burden
- no redemption obligation

[Mark the FIRST ONE point only.] } @2 max: 2

Disadvantages:
- diluting the control right over the firm
- higher risk of being taken over

[Mark the FIRST ONE point only.] } @2 max: 2

(c) Reasons:
- cost of advertising shared by a larger number of students
- bulk purchase of raw material in production
- more extensive division of labour
- Any other relevant point

[Mark the FIRST THREE points only.] } @1 max: 3

Marks

3. The law states that (holding technology constant) when more units of a variable factor are added successively to a given quantity of fixed factors, the marginal products of this factor will eventually diminish. (3)

Yes, when labour increases from 3 to 4 units, the marginal product of labour drops from 18 to 14 units, so the law of diminishing returns holds. (3)

Marks

4. Taking photos may disturb other people in the restaurants/sharing the photos in the social media may disclose the design of dishes. Both possibilities may have an undesirable effect on the revenue/profit of the restaurants, but such effects are not compensated (financially or otherwise) by the photo-takers. Such photo-taking-and sharing behaviour may thus involve negative externality (external cost is involved). (3)

<u>or</u> <u>or</u>

Taking photos and sharing them in social media may have a promotion effect, attracting more customers—bringing higher revenue/profit—to the restaurant, but the photo takers do not receive compensation for such benefits. Such photo-taking-and sharing behaviour may thus involve positive externality (external benefit is involved). (3)

Marks

5. When the price level increases, the adjustment of input prices is imperfect/incomplete (e.g. due to the long term contracts of factor of production), so the real cost of production —i.e. nominal cost divided by the general price level—will fall. Firms would thus use more factor inputs to produce larger output. Therefore, the SRAS curve is upward-sloping, i.e. a higher price level would result in a higher output level. (3)

6. (a) The unemployment rate = 200 000/(3 800 000+200 000)×100% = 5% **Marks** (2)

(b) Loss caused by unemployment:
- loss of output
- loss of human capital
- political and social unrest
- any other relevant point

[Mark the FIRST THREE points only.] @1 max: 3

(c) Economic phenomena:
- rising real GDP growth rate
- rising inflation/lower deflation
- rising levels of investment/consumption
- any other relevant point

[Mark the FIRST TWO points only.] @1 max: 2

Marks

7. (a) In Country A, the opportunity cost of producing 1C = 6/2= 3T (3)
The terms of trade: 1C will exchange for (11/2=) 5.5T
As the opportunity cost of producing 1C is lower than the terms of trade,
Country A will produce and export C.

(b) The gain from trade = 5.5−3−2 = 0.5T per unit of C. (3)

Marks

8. (a) Monetary base = \$500 million + \$1000 million = \$1500 million (1)
Money supply = \$500 million + \$4000 million = \$4500 million (1)

(b) Change in monetary base = \$1500 million − \$1500 million = 0 (2)

Change in money supply (2)
= New money supply − Original money supply
= (\$500 million + \$1000 million × 2) − \$4500 million = −\$2000 million

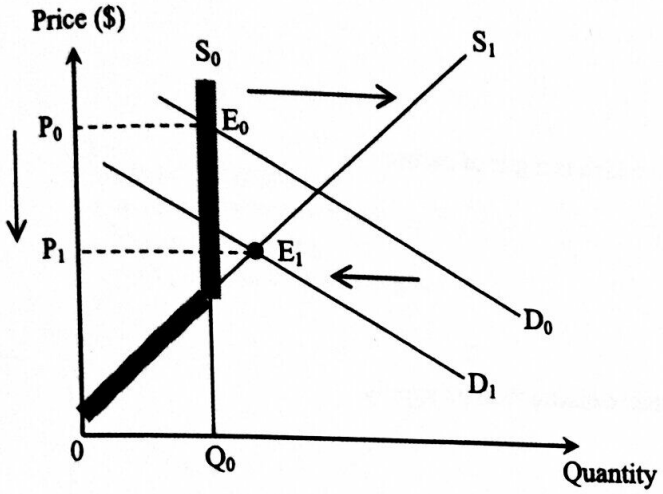
or (2)
Change in money supply
= Change in cash held by non-bank public + Change in deposits
= 0 + (\$1000 million × 2 − \$4000 million) = −\$2000 million

(c) (i) Under a fractional reserve banking system, banks are required to keep only a fraction of their deposits as reserves. They can create credit by lending out the remaining fraction in the form of loans to businesses and private individuals, which would eventually find their way back into the banking system in the form of deposits, resulting in a multiple increase in deposits/a banking multiplier larger than unity. (3)

(ii) If the legal reserve ratio is 100% (RRR=1) or if all of the banks decide not to lend out their excess reserves even when RRR<1 (e.g. during financial crisis, when default rates are high), the money supply will be equal to the monetary base. (1)

9. Illustrate in the diagram: **Marks**

- Embargo effect: leftward shift of demand curve (1)
- An original kinked supply curve S_0, with the vertical segment at the quota level Q_0 (1)
- Quota-abolition effect: A new upward-sloping supply curve, overlapping the kinked one below the original quota level Q_0 (1)
- Intersection of new demand curve (D_1) and new supply curve (S_1) results in a reduction in P (1)



Section B

Marks

10. (a) Monopolistic competition. (1)

Features:
- Many sellers
- Price searchers
- (slightly) differentiated products
- Non-price competition
- Imperfect market information
- Any other relevant point

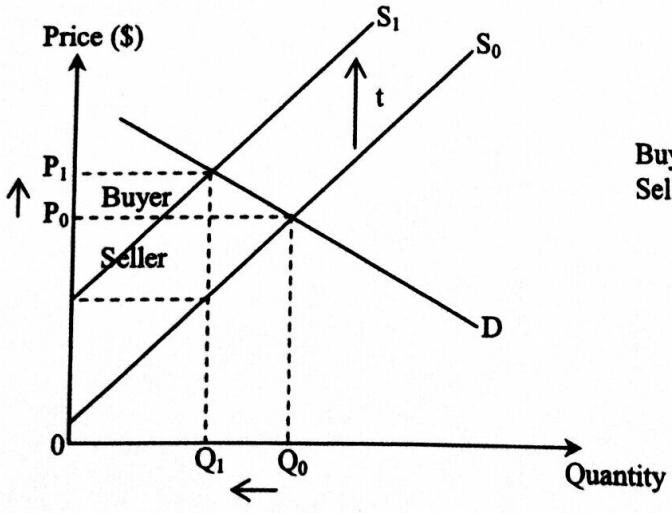
[Mark the FIRST TWO points only.] @1 max: 2

(b) Land. It is because it is a natural resource which is a gift of nature. (2)

(c) Verbal elaboration:
- Condition: demand for solar panels is more elastic than its supply. (2)

Indicate in the diagram:
- upward shift of the supply curve (1)
- P increases (1)
- Q decreases (1)
- Correct position of buyers' burden and producers' burden (1)
- buyers' burden < producers' burden (1)

Chinese Solar panels sold in European Union



Buyer = buyers' burden
Seller = producers' burden

11. (a) No. **Marks**

(1)

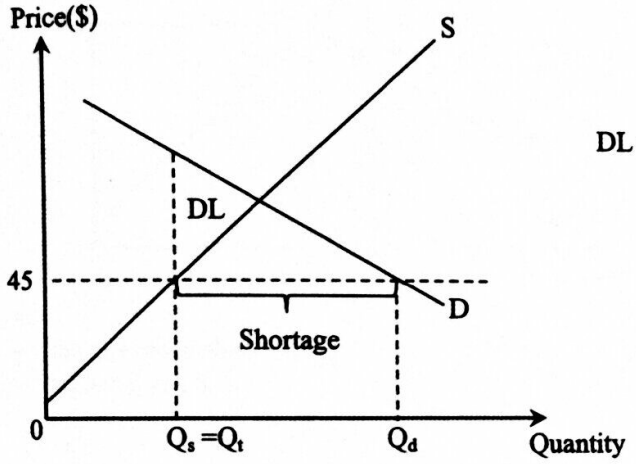
because public services are usually subsidized—i.e. provided at or below cost, which is in turn lower than market price. Their contribution to GDP (or market value), computed using market price, would thus be higher than \$45 (the subsidized price charged by the clinic). (2)

or

because the public services which are not sold at the market price will be counted using factor cost in the GDP, which is higher than \$45. or (2)

(b) Illustrate in the diagram:

- Price set below equilibrium[1] (1)
- Correct position of Q_t (1)
- Correct position of deadweight loss (1)



DL = deadweight loss

Verbal elaboration:

- Price is set at \$45 which is below equilibrium. (1)
- Quantity transacted is below equilibrium quantity or there is underproduction or shortage. (1)
- Marginal benefit > Marginal cost (1)

(c) Equalize income/outcome: basic medical service acts like a transfer or subsidy-in-kind, enjoyed mainly by the low-income group; The high-income group may choose not to "queue up" for such medical benefits and turn to private medical service instead. (2)

or

Equalize opportunities: basic medical service provided to patients with chronic diseases would improve their health, allowing them to continue to work and earn income. Therefore, their income would not be affected by their ability to afford medical service (their background), but rather by their work effort. or (2)

[1] The difference between the terms "equilibrium" and "market clearing" is not required.

(d) Equity:
After the fee raise, the poor may no longer be able to afford the fee and thus be deprived of the opportunity to enjoy the medical services. Equity may be worsened as the poor cannot enjoy the transfer/subsidy while the rich can still use the service. (2)

or

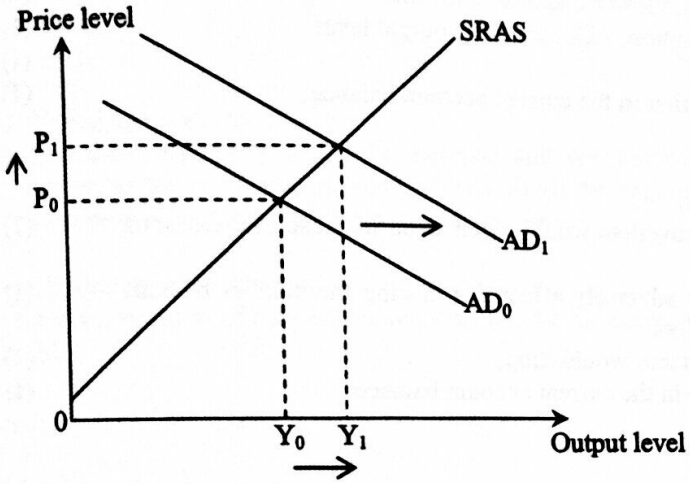
Or
After the fee raise, the poor may no longer be able to afford the fee and thus be deprived of the opportunity to enjoy the medical services. The poor may then be deprived of the chance to work and earn income due to their poor health. (2)

Efficiency:
The fee increase would improve efficiency as it results in a price closer to the equilibrium level, thus narrowing the gap between MB and MC and reducing the size of deadweight loss. (2)

12. (a) The relative importance of the gaming industry has been declining because its gross revenue has been falling faster than GDP at current market price. **Marks** (2)

(b) Verbal elaboration:
- The cash-sharing scheme would raise the disposable income of the residents (1)
- and therefore result in an increase in consumption. (1)
- AD would rise, (1)
- raising price and output levels accordingly. (1)

Illustrate in the diagram:



- the rightward shift of AD (1)
- higher P and Y (1)

(c) Arguments for:
- Investment would increase potential output over time, but cash sharing would not have similar long-run effects on the economy.
- Investment would raise AD directly. But the cash-sharing scheme could only raise AD indirectly via an increase in consumption. In case the residents choose not to spend the cash received on consumption, the AD effect would vanish.
- Any other relevant point

} @2 max: 3

Arguments against:
- During economic downturn, a reduction in social welfare due to suspension of the cash-sharing scheme may result in discontent of the citizens and political instability.
- While people can benefit from the cash-sharing scheme instantly, it may take a longer time for investment to boost their income.
- Public investment may be inefficient due to high administrative costs or low sensitivity to market/price signals (lack of profit incentives).
- Any other relevant point

} @2 max: 3

Remark: Maximum mark of part (c) is 5 marks

		Marks
13. (a)	Division of labour/specialization Reasons: – practice makes perfect – choosing the most suitable person for the job – save time in training – stimulus to mechanisation – Any other relevant point [Mark the FIRST THREE points only.]	(1) @1 max: 3
(b) (i)	Proposal A on current account: an increase in income tax would lower disposable income and result in a drop in consumption, AD, as well as output level Import would fall, implying a bigger surplus or smaller deficit in the current account balance.	(1) (1) (1) (1)
	Proposal B on current account: A fee charged on departing travellers would result in an increase in the cost of using the airport. Travelling industry would be adversely affected, reducing the number of both incoming and outgoing travellers. Both import and export of services would drop, causing an ambiguous change in the current account balance.	(1) (1) (1) (1) max: 6
(ii)	Proposal A on average flight distance: After the tax increase, some poor people would be unable to afford long-distance flights and would switch to short-distance flights, thus reducing average flight distance. **or** The increase in income tax would not affect the relative price between short-distance flights and long-distance flights, so consumption of the flights would not be affected. **or** After the tax increase, some poor people would be unable to afford the flights. As budget-constrained people would often take short-distance flights, the drop-out of these travellers would result in an increase in average flight distance.	@2 max: 2
	Proposal B on average flight distance: A lump-sum fee charged on both long-distance and short distance travellers will result in a drop of the price of long-distance flight relative to short-distance flight. A higher proportion of travellers will thus take long-distance flights, increasing the average flight distance.	(4)

Remarks: Maximum for (b) is 10 marks.

Section C

14. (a) (i) – Correct position of Q_m — Marks (1)
– Correct position of P_m (1)

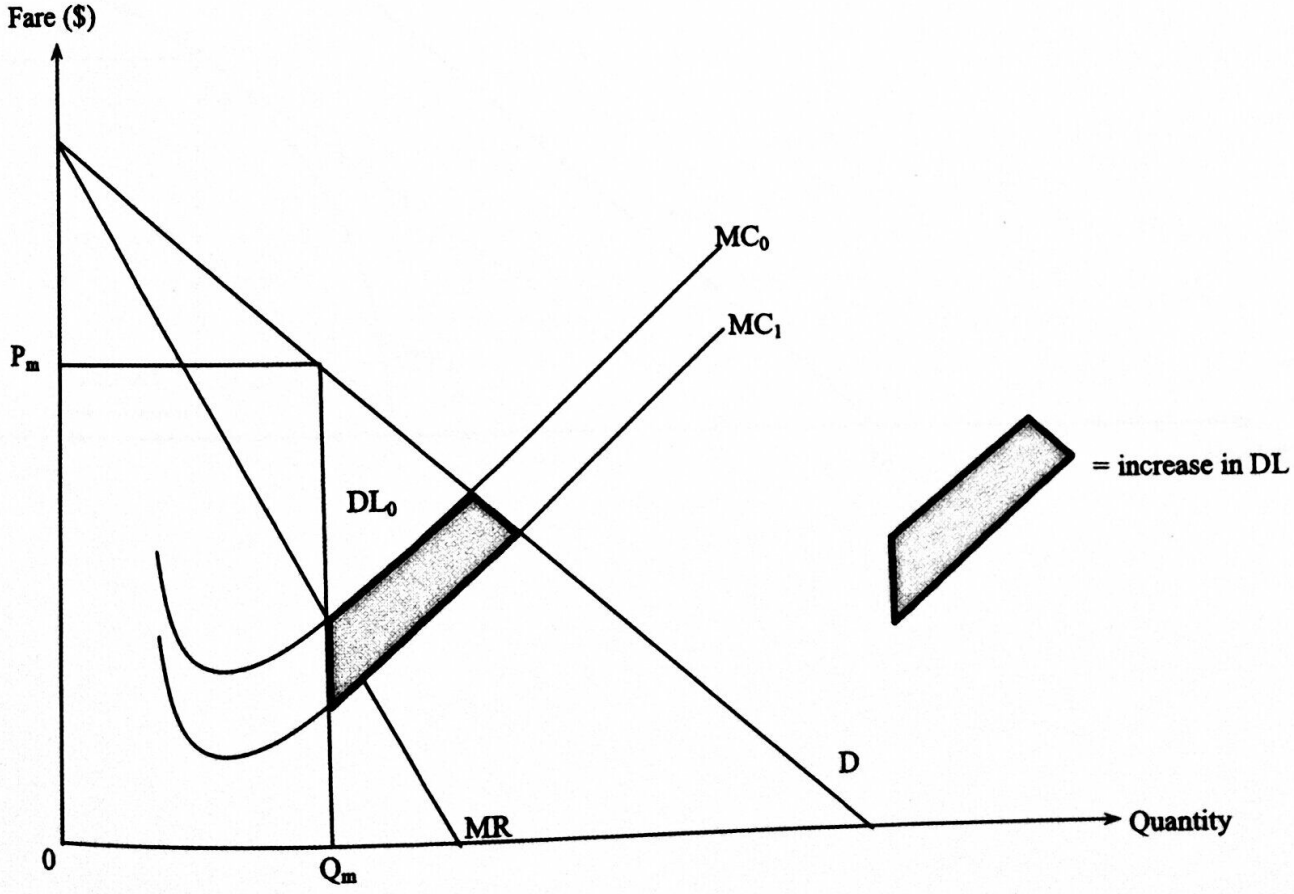
(ii) Illustrated in the diagram:
correct position of DL_0 (1)

Verbal elaboration:
At Q_m, marginal benefit (MB) is higher than marginal cost (MC). (1)

(b) (i) The reduction in fuel cost reduces the marginal cost. (1)

(ii) Verbal elaboration:
Economic efficiency would be lowered and the deadweight loss would be larger, as the gap between MB and MC would be enlarged and output would now be even further away from its efficient level. (2)

Illustrated in the diagram:
correct position of new DL/increase in DL/the increased gap between MB and MC (1)



(c) Yes. As two groups of consumers (adults and children) are charged different prices for the same good (ferry service) produced at the same cost. (3)

(d) (i) If owners of the seafood restaurants agree to engage in price fixing and raise the price together (i.e. collusion), they would violate the first conduct rule under the Competition Ordinance. (3)

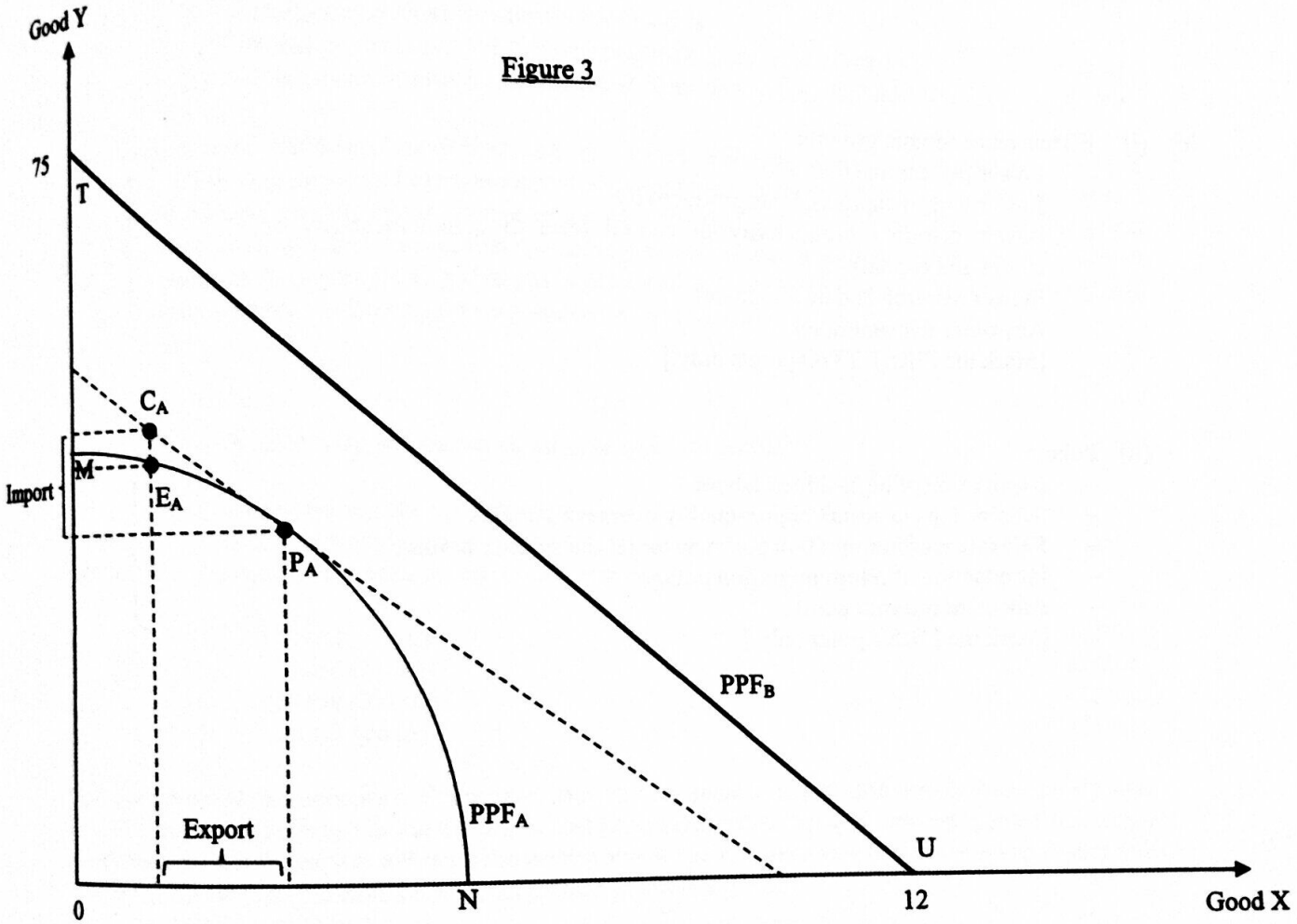
(ii) The price increase may be a market response to increased demand for seafood meals during public holidays due to a bigger number of visitors. (2)

or

The price increase may be a result of reduced supply of seafood meals due to higher production costs (e.g. need to hire more part-time workers) on public holidays. (2)

15. (a) The marginal costs of producing of both X and Y are increasing in Country A. **Marks** (1)

(b) Country A's opportunity cost of producing 1X = 4Y (1)
Country B's opportunity cost of producing 1X = 6.25Y (1)
Country A has a lower cost in producing X, and thus it has a comparative advantage in producing X. (1)



(c) Indicate in the diagram: (1)

(i) The correct position of P_A (1)

(ii) The correct position of C_A (1)

(iii) The correct volume of export (1)

The correct volume of import

(d) No, because the opportunity cost of producing X (and Y) will be unaffected by this technological change. (2)

(e) (i) Effects on economic growth:

- Lower per-capita GDP
- Lower human capital/labour productivity
- Lower marginal productivity of capital (due to complementarity of labour and capital)
- Slower research and development
- Any other relevant point

[Mark the FIRST TWO points only.]

} @2 max: 4

(ii) Policy:

- Importation of high-skilled labour
- Scholarships to attract higher-quality overseas students
- Relaxation of immigration policy to target the smarter brains
- Introduction of return migration policy
- Any other relevant point

[Mark the FIRST point only.]

} @2 max: 2