Paper 1

Candidates' overall performance was good. The mean score of this paper is 26 out of 43. The following questions deserve special attention.

Q.15 A decrease in the cost of producing Good X results in a 5% and 10% change in its price and quantity transacted respectively. Which of the following best explains the above changes?

*A.	Good X is a durable good.	
B.	There are no close substitutes for Good X.	(37%)
C.	Firms producing Good X have excess capacity in production.	(20%)
D.	The factors of production for Good X are not easily available.	(32%)
		(11%)

This question tests candidates' understanding of factors affecting demand and supply and their elasticities. Many of them seemed to understand that either/both of the demand for and supply of Good X is/are elastic because the percentage change in the quantity transacted is bigger than that in the price. However, some candidates failed to see that the fall in production cost had resulted in a rightward shift of the supply curve, so the corresponding changes in price and quantity transacted represented a movement along the demand curve—reflecting the responsiveness of consumers rather than producers.

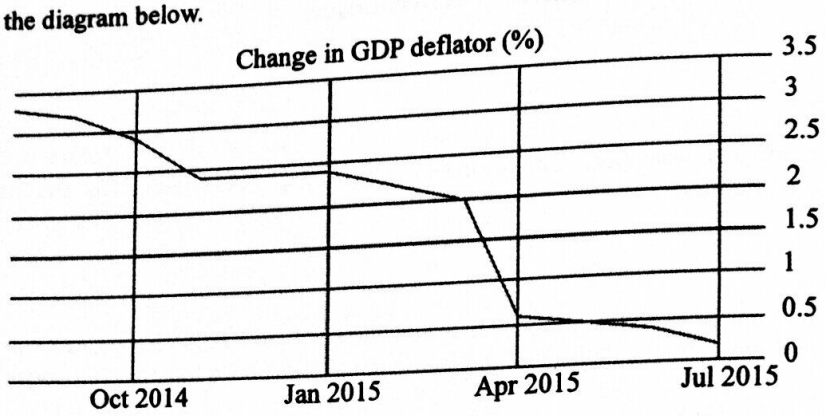
Q.20 Which of the following statements about monopoly are correct?

(1) A monopolist sets the market price.
(2) A natural monopoly arises when no firms are permitted to enter the market.
(3) There are substitutes for the products provided by a monopolist.

A.	(1) and (2) only	(42%)
*B.	(1) and (3) only	(26%)
C.	(2) and (3) only	(11%)
D.	(1), (2) and (3)	(21%)

This question is about monopoly. Some candidates did not seem to understand that the monopoly power behind a "natural monopoly" lies in the firm's cost advantage, rather than government regulations. Other candidates did not realise that although the monopolist is the sole producer of its own good, it may still face potential competition from other firms producing similar goods.

Q.24 Study the diagram below.



The diagram shows that during the period from October 2014 to July 2015,

A. the nominal GDP was falling. (15%)
B. the purchasing power of money was increasing. (23%)
C. the growth rate of real GDP was higher than that of nominal GDP. (25%)
*D. the nominal interest rate was higher than the realised real interest rate. (37%)

This question tests candidates' ability to extract relevant information from the data/figure to identify the correct economic phenomenon. Nearly half of the candidates confused disinflation (the case here) with deflation, hence picking B or C as their answer. To get the correct answer, candidates had to understand that the difference between the nominal interest rate and the actual (realised) inflation rate is the realised real interest rate.

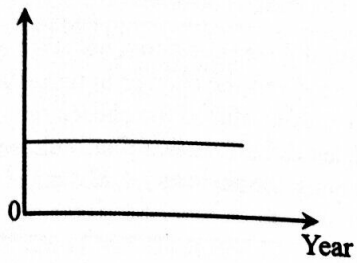
Q.33 In a fractional reserve banking system, the actual deposit created is often below the maximum possible deposit created. The gap between these two amounts will be narrowed when

A. the popularity of electronic payment increases.
B. the central bank tightens the restrictions imposed on mortgage loans from banks.
C. the central bank buys bonds from the public.
D. the central bank reduces the legal reserve ratio for banks.

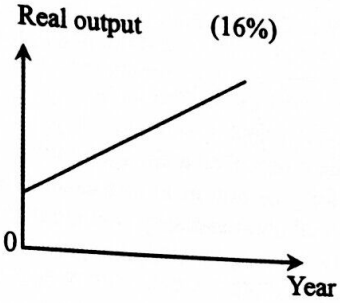
This item was deleted as it did not effectively assess candidates' knowledge and understanding. This question tests simultaneously candidates' knowledge of the creation of both (i) actual deposits and (ii) maximum-possible deposits as well as the change in their relation in different cases. Maximum-possible deposit is calculated under the assumptions of no cash leakage and no excess bank reserves—the "benchmark". Many candidates seemed to understand that while an expansion in the monetary base (option C) or a reduction in the legal reserve ratio (option D) would increase both (i) and (ii), the tightening of loan restrictions (option B) would only reduce (i) without altering (ii). Following the same logic, candidates might have concluded that people holding less cash for transaction purpose (option A) would only raise (i) without affecting (ii). Such conclusion, however, overlooked the implicit assumption of zero cash leakage in the benchmark and the fact that reserves in the bank may be altered by the cash holding of the public.

Q.34 According to the classical quantity theory of money, which of the following diagrams is correct when money supply is growing at a constant percentage each year?

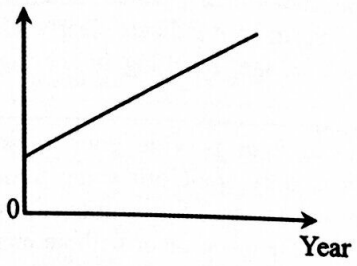
A.



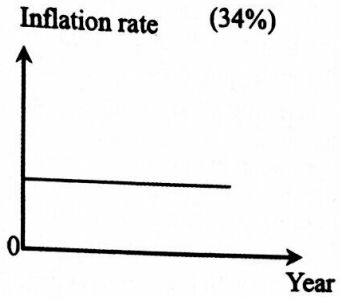
B.



C.



*D.



This question is a test of the classical quantity theory of money (QTM) via graphical representation of economic data. Many candidates were able to apply the QTM in the given case to deduce that a growing money supply would result in a rising price level, i.e., a positive rate of inflation. However, quite a number of candidates did not realise that, under QTM, the price level should be increasing at a constant rate, meaning that the inflation rate should be constant over time. Some might have mis-read the label of Y-axis ("Inflation rate") in option C as "Price level" and thus mis-conceived the upward-sloping straight line as representing a constant inflation rate. Candidates should be more cautious about the distinction between price level and inflation rate (i.e., percentage change in price level over time).

Q.38 If the government simultaneously increases its expenditure and income tax by the same amount, the effect on the aggregate output is _____.

A. contractionary
B. neutral
C. expansionary
D. indeterminate

This item was deleted as it did not effectively discriminate between weak and able candidates. This question examines the combined effect of an equal increase in government expenditure and income tax on aggregate output. Candidates might have overlooked the possible effect of the tax change on aggregate supply. In particular, the increase in the income tax may have a disincentive effect on labour supply, which would then lower aggregate supply. Combining the effects on aggregate demand and aggregate supply would result in an indeterminate change in aggregate output.

Paper 2

Section A

Q. number	Performance in General
1	Fair. Most candidates managed to define opportunity cost correctly, but some of them failed to relate it to the given case. Many misperceived the change in resale value of the new model as a change in monetary cost, or they confused the chosen option with the forgone option in this case. Some candidates did not notice that both monetary cost and non-monetary cost were involved in buying the new model, and thus failed to apply the concept of full cost to this case.
2(a)	Excellent.
2(b)	Good. Ignoring the key words "from the viewpoint of owners," some candidates gave totally irrelevant answers. A minority of candidates did not indicate clearly whether a particular argument is an advantage or a disadvantage, resulting in scoring fewer marks.
2(c)	Satisfactory. A majority of candidates were able to provide good reasons for economies of scale. A minority of candidates only spelt out some terms (e.g. marketing economies) or phrases (e.g. resources are fully utilised) without elaborating with reference to the given situation in the question or without relating to the reduction in average cost.
3	Excellent. A small number of candidates wrongly applied the concepts of "fixed cost / variable cost / average product".
4	Satisfactory. The following are common mistakes: – failure to state whether the externality was positive or negative; – giving confusing arguments without specifying who got the benefit and who needed to be compensated.
5	Satisfactory. Many candidates were aware that the incomplete/slow adjustment of input prices was the key reason. However, some failed to relate their argument to the price level and output level in their elaborations: they neither started their argument from a change in general price level, nor did they reach the conclusion of a change in output level at the end. A few candidates wrongly used the terms price (rather than the price level) and quantity supplied (rather than aggregate output) in their explanation, showing either their confusion of supply-demand model with AS-AD model or their carelessness.
6(a)	Good. A few candidates wrongly included the underemployed population in their calculation.
6(b)	Satisfactory. A common mistake was to regard the rise of unemployment benefits—a transfer payment—as a loss to society.
6(c)	Excellent. A small number of candidates did not read the question carefully, and included "the fall in unemployment rate" as part of their answers.
7(a)	Satisfactory. Many candidates compared correctly the costs of domestic production of Country A with the terms of trade to determine the type of good exported by Country A. Common errors for those who failed to get the answer: – miscalculation of the opportunity cost from the input-requirement data; – mistakenly comparing the unit costs of producing the two goods directly in terms of their input requirements.
7(b)	Satisfactory. Most candidates were able to show their knowledge about the gain from trade in the case of positive transportation cost.

Q. number	Performance in General
8(a)	Excellent.
8(b)	Satisfactory. Most candidates used correctly the new required reserve ratio (RRR) in their calculation. However, some of them simply calculated the new levels of money supply and monetary base without finding their changes (relative to their old levels). A few of them were not given full credit because they did not show their workings or omitted the units. Weaker candidates failed to work out the case of change in RRR with constant reserves.
8(c)(i)	Fair. Many candidates were able to show their basic understanding of credit creation, but only some of them stated precisely the underlying assumptions. Others tried to apply the formulae for monetary base and money supply (which deserves some credit), but very few candidates were able to relate the difference between the two to the fractional reserve system (i.e. RRR<1).
8(c)(ii)	Satisfactory. Many candidates were able to state that credit creation would not work when RRR=1, or when banks do not make loans and hold all deposits as reserves.
9	Good. A majority of candidates correctly showed the effect of an embargo by shifting the demand curve leftward. Some also demonstrated a good knowledge of quota by drawing the kinked supply curve. However, a few of them misunderstood the key word "abolish" as meaning introduction of a quota, and thus reached a wrong conclusion. Some candidates also failed to represent the equilibrium price and quantity at the intersection of demand and supply curves. A minority of candidates mistakenly used the small open economy model to address this large country question.

Section B

Q. number	Performance in General
10(a)	Good. Many candidates stated correctly the market structure of the industry. However, some candidates wrongly focused on the top 10 manufacturers (whose market shares were actually rather small) and gave oligopoly as their answer. Confusing terms such as "monopoly competition", "monopolistic" and "競爭性壟斷" were found in some of the answers.
10(b)	Good. A minority of candidates wrongly regarded sunlight as capital. Some mis-read the question and went on to explain the type of factor inputs for producing PV modules or to explain the type of production of the solar energy industry.
10(c)	Good. Most candidates were able to draw the diagram with labels showing the correct positions of the tariff burdens. However, unclear concepts were revealed in some candidates' verbal explanation. Some only stated elastic demand as the condition, but failed to relate the tariff burden to the difference in the elasticities of demand and supply. A few candidates mis-used the model of small open economy (though partial credits were still given). A minority wrongly discussed the distribution between consumer and producer surpluses.
11(a)	Poor. Many candidates misinterpreted the question as meaning "whether the $45 should be included in the calculation of GDP"—a frequently asked question in past papers. Some over-emphasised the imported raw materials (medicine) and reached the wrong conclusion of "less than $45". Among those who got their stand correct, only some of them provided a good explanation.
11(b)	Satisfactory. Most candidates managed to draw a well-labelled diagram for the case of excess demand, while many were able to indicate the position of deadweight loss. However, only a few of them were able to accurately state that the inefficiency was caused by MB>MC in this case. A minority of candidates represented their answer in a diagram of marginal social cost and marginal private cost, which was neither required under the existing curriculum and assessment framework nor applicable to this question.

Q. number	Performance in General
11(c)	Good. Most candidates were able to give an explanation in their own words, but only some made use of the concepts of "equalising income/opportunity" in their answers.
11(d)	Good. Many candidates were able to demonstrate their understanding of the effects of the fee increase on efficiency and equity, and some could explain the efficiency-equity trade off in this case as well. The following shows a list of mistakes: – thinking that they were only required to provide reasons to support the argument; – mis-labelling their statement about efficiency under the heading of equity, or vice versa; – failure to provide an explanation for their stand using economic terms.
12(a)	Poor. Many candidates were able to identify the trends of the income of the gaming industry and the GDP of Macau, but failed to relate those data to the relative importance of the gaming industry. Among those who got the trend correct, only some gave accurate explanations based on the data. Instead, some others suggested reasons for the drop in the revenue, such as a reduction in tourist numbers.
12(b)	Excellent. Most candidates provided a systematic explanation for the effect of the cash-sharing scheme on price and output levels with the aid of a well-labelled diagram. A minority of candidates mistook a rise in transfer payment for a rise in government consumption expenditure, or an increase in money supply. Others confused disposable income with taxable income in their answers.
12(c)	Poor. Most candidates were able to either support or oppose the economist's suggestion in economic terms. However, only some managed to provide a balanced analysis by including both the pros and the cons. The following problems were identified: – presenting argument(s) exclusively for or exclusively against the suggestion; – failure to compare the extent of change in AD due to the change in investment with that due to an equal-amount change in transfer payment; – mistakenly relating investment to a higher profit tax and cash-transfer to a higher sales tax, and then putting forward arguments in terms of the effects on the budgetary position of the Macau government.
13(a)	Excellent. Only a minority of candidates mistakenly regarded efficient use of capital goods and saving training cost as reasons for higher labour productivity.

Q. number	Performance in General
13(b)	Fair. Most candidates attempted to identify the effects of the two proposals, but only some demonstrated their ability to apply economic concepts and theories correctly in this case. The following shows a list of mistakes for both parts that deserve attention: - comparing the effects of building and not building the additional runway rather than the effects of the two proposals to finance the construction of the runway; - mis-reading the question as meaning "how proposal A affects the current account" and "how proposal B affects the average flight distance"; - poor organization of answers, without a clear indication as to which of their arguments refers to which proposal. **Part (i)**: For proposal A, the performance was fair. Most candidates simply stated that the increase in income tax would lower disposable income and consumption, while the stronger candidates were able to relate the fall in consumption to a fall in output as well as imports, and ultimately the current account. For proposal B, many candidates did not realise that the expenditure/revenue of the tourist industry was counted as import/export of services and that the rise in the cost of using the airport would adversely affect both foreign visitors and local people flying to other countries. Some candidates gave confusing answers without indicating whether they were talking about incoming or outgoing travellers. **Part (ii)**: For proposal A, the performance was fair. Some candidates showed their ability to apply concepts and theories to an unfamiliar situation. Others only stated their stand (increase / decrease / no change) without proper reasoning. For proposal B, the performance was satisfactory. Most candidates could apply the law of demand to deduce that the average flight distance would increase. Although many were able to use the concept of relative price, only some of them were able to give a complete and logically consistent explanation. Common mistakes include: - inability to state, in words or in formulae, that the same lump-sum fee was charged on the two types of flights with different flight distances and airfares; - stating that the relative price of long-distance flights would become lower than that of short-distance flights; - failure to understand that the fall in the relative price of long-distance flights would lead to a rise in the proportion of such flights (relative to short-distance ones) taken by departing travellers without necessarily increasing their total quantity.

Section C

Q. number	Popularity	Performance in General
14(a)(i)(ii)	53%	Good. Most candidates were able to indicate correctly the output and price and explain why deadweight loss exists under monopoly pricing. A minority of candidates did not use the symbols Q_m and P_m as required.
14(b)(i)(ii)		Candidates' performance in part (i) was excellent. However, the performance in part (ii) was fair, as some misconceived an upward shift in the marginal cost (MC) curve as a reduction in marginal cost. Among those who were able to draw the correct MC curves, some failed to give a proper explanation for the increase in the deadweight loss.
14(c)		Good. Most candidates performed well in this question about price discrimination (PD). Weaker candidates only recited the definition of PD without relating it to the given case, or simply stated it as an example of third degree PD.
14(d)(i)(ii)		Satisfactory. In part (i), most candidates could identify the type of anti-competitive behaviour and correctly stated that it is a horizontal agreement or that it violates the first conduct rule. Some candidates did not provide reason(s) for the change in demand /supply in part (ii).
15(a)	47%	Satisfactory. However, some candidates gave incomplete answers, such as "resources are heterogeneous" or "products are heterogeneous".
15(b)		Excellent.
15(c)(i)(ii)(iii)		Satisfactory. Most candidates were able to indicate the correct position of P_A, but only some actually knew that Country A's import and export volumes were represented by the gap between its production point and consumption point for Good Y and Good X respectively.
15(d)		Good. Many candidates gave a good explanation for the unaffected trade direction. A minority of candidates did not indicate their stand.
15(e)(i)(ii)		Satisfactory. In part (i), most candidates could explain clearly how brain drain might slow down economic growth via different growth channels. In part (ii), some candidates misunderstood the key words "brain drain" and "in the light of globalisation", and thus gave irrelevant answers. Candidates were expected to explain how their policy proposal can offset the reduction in labour productivity or human capital through interactions with the rest of the world.

General comments and recommendations

1. Some candidates lack a thorough understanding of basic economic concepts and principles, especially when applying them to solve hypothetical or real-life problems. Candidates should strengthen their analytical skills instead of simply regurgitating concepts and theories.

2. Some candidates do not always read the questions carefully. Candidates should devote special attention to the assumptions and conditions laid down in the questions to avoid giving irrelevant answers.

3. Some candidates have difficulty in presenting their answers in a precise way. Candidates should equip themselves with better language abilities as well as graphical skills.

4. Some candidates lack awareness of current economic issues in our society. Candidates should pay more attention to economic news.

5. Some candidates lack skills to extract information from tables and graphs as well as to draw well-labelled diagrams. Candidates should pay special attention to the headings, labels and axes as they are essential to our understanding of the data presented therein.