

(d) No. If the world price of Good X falls such that it is lower than the domestic opportunity cost (i.e.,  $1X < 1.5Y$ ), Country A will no longer have a comparative advantage in producing Good X.

Marks

(3)

(e) Reasons:

- Closing the door to those foreign workers who possess better knowledge and/or skills than domestic workers would lower the average level of human capital in Country A (and may even reduce its investment in human capital), and thus slow down its output growth.
- Closing the door to foreign trade would eliminate possibilities of importation of better-quality capital (machines and equipment) and superior production technology from foreign countries, and thus create negative effects on technological improvement and output growth in Country A.
- Loss of foreign funding in support of research and development in Country A, thus lowering its rate of technical progress.
- any other relevant point

(2)

(f) Reasons:

- Health of citizens in Country A may deteriorate due to loss of opportunities to import new and more effective medicine, better-trained doctors, and superior medical equipment and technology from foreign countries.
- Average level of education in Country A may be lowered due to closing down of international schools and departure of foreign teachers (as well as foreign students).
- any other relevant point

(2)

## Candidates' Performance

### Paper 1

Candidates' overall performance was good. The mean score of this paper was 26 out of 45. The following questions deserve special attention.

Q.2 Which of the following statements are related to the problem of 'for whom to produce'?

- (1) Only the elderly and eligible persons with disabilities can enjoy a concessionary fare of \$2 per trip under the Public Transport Fare Concession Scheme.
- (2) Public rental housing (PRH) households whose family income exceeds 5 times the PRH income limits should vacate their PRH flats.
- (3) The e-Sports & Music Festival moved from Hong Kong Convention and Exhibition Centre to Hong Kong Coliseum to house more fans from all over the world.

- |                      |       |
|----------------------|-------|
| *A. (1) and (2) only | (45%) |
| B. (1) and (3) only  | (20%) |
| C. (2) and (3) only  | (2%)  |
| D. (1), (2) and (3)  | (33%) |

The question aims at testing candidates' understanding about the problem of 'for whom to produce'. Statement 3 is the major distractor. As the target audience of the e-Sports & Music Festival (i.e., fans from all over the world) remains unchanged, the change of venue in order to accommodate more fans is not related to the problem of 'for whom to produce'. Option D (as well as options B and C) is thus incorrect.

Q.9 A Hong Kong travel company offers package tours to Japan. It invested in building a hotel, which provides accommodation services to its tour members visiting Japan.

Which of the following is most likely the motive behind the expansion?

- |  |       |
|--|-------|
| A. to increase the market share              | (10%) |
| *B. to secure the supply of factor inputs    | (31%) |
| C. to ensure a market outlet of its services | (54%) |
| D. to reduce competition                     | (5%)  |

Most candidates were able to rule out Options A and D, as they recognised the input-output relation between hotel services and package tours. But many of them mistook Option C for the key, which would have been correct if a hotel expanded its business to package tours, but not the other way round (as in the case provided in the question). By building a hotel of its own, the travel company could make sure that there would be enough hotel rooms (which can be viewed as a factor input) for their package tours.

Q.22 Suppose there is a bad harvest of flowers due to global warming. The marginal benefit of flowers will \_\_\_\_\_ and the total exchange value \_\_\_\_\_.

- A. decrease ..... will decrease (14%)
- B. increase ..... will increase (4%)
- C. decrease ..... may decrease or increase (47%)
- \*D. increase ..... may decrease or increase (35%)

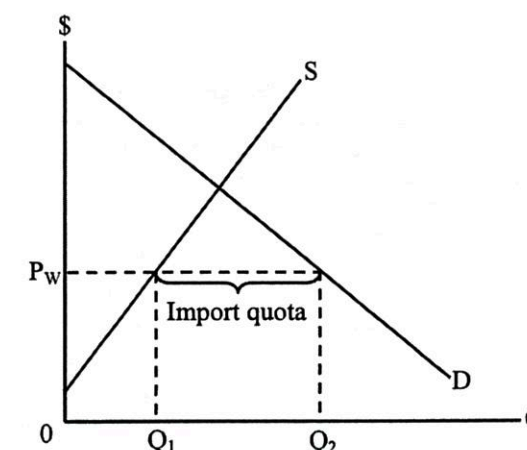
A bad harvest means that there is a significant reduction in the supply of flowers. As a result, the marginal benefit of flowers, as reflected in their price, would rise. Its effect on the total exchange value of (or total expenditure on) flowers depends on their elasticity of demand, and is thus uncertain.

Q.34 Both the wage rate and general price level increase by 8% in a certain year. If the government increases the salaries tax allowance by 5%,

- \*A. more people will fall into the tax net. (28%)
- B. income distribution will be more even. (29%)
- C. government's tax revenue will decrease. (14%)
- D. people's real income after tax will increase. (29%)

As the percentage increase in tax allowance (5%) could not catch up with that in nominal wages (8%), some people who were initially exempted from salaries tax (i.e., tax allowance > wages) may now have to start paying taxes (i.e., tax allowance < wages). Since there is no information whether the salaries tax is progressive or proportional, its effect on income distribution and on real after-tax income cannot be determined.

Q.43 The following is the supply-demand diagram of Good X in a small open economy.



Initially the economy imports Good X at the world price ( $P_w$ ) and the government imposes an import quota of  $(Q_2 - Q_1)$  units. Suppose the world price of Good X drops. Which of the following statements is correct?

- \*A. The domestic price of Good X will remain at  $P_w$ . (30%)
- B. The domestic price of Good X will fall. (37%)
- C. The domestic supply curve will shift to the right. (14%)
- D. The quantity of domestically produced Good X will increase. (19%)

The supply of Good X in a small open economy consists of two components: Good X produced by local producers and Good X imported from foreign countries. Given the quota is effective, the total quantity of Good X imported depends on the size of the quota, not on the world price of Good X. Therefore, both the local supply and the import quota would remain unchanged. Diagrammatically, the total supply curve ( $S + \text{quota}$ ) would intersect the demand curve at the same point as before, resulting in the same domestic price ( $P_w$ ) and same quantity transacted ( $Q_2$ ) in the domestic market.

Q.45 Study the prices of iPhone X in Hong Kong in terms of Hong Kong dollar (HKD) and in the Mainland in terms of Renminbi (RMB).

Hong Kong	The Mainland
HKD 8588	RMB 8316

Given the exchange rate of HKD 1 = RMB 0.875, which of the following statements is correct?

- A. Travellers tend to buy an iPhone X in the Mainland instead of in Hong Kong. (13%)
- B. RMB is under-valued as the price of an iPhone X in the Mainland is lower than that in Hong Kong. (7%)
- \*C. If the transportation cost is HKD 950, buying an iPhone X in Hong Kong and re-selling it in the Mainland will no longer gain. (45%)
- D. The potential gain from 'buy low, sell high' will disappear when the price of iPhone X in Hong Kong is higher than HKD 9504. (35%)

Most candidates were able to apply their knowledge about exchange rate to rule out Options A and B. Many candidates made use of the technique for calculating the gains from trade to pick Option C as the answer: Trade would no longer be beneficial when the transportation cost is higher than the potential gain (i.e.,  $950 > 8316/0.875 - 8588$ ). Some candidates failed to notice, though, that the potential gains from trade as well as the direction of trade could be reversed by a change in price/cost (in either place or both): If the price of an iPhone in Hong Kong is higher than HKD 9504, then traders could gain by buying one from the Mainland (at  $8316/0.875 = 9504$ ) and selling it in Hong Kong (at a price above HKD 9504), and thus option D is incorrect.

Paper 2

Section A

Q. number	Performance in General
1(a)	Good. A few candidates provided incomplete answers, stating merely that there was no change in the forgone option(s), without further elaboration.
1(b)	Satisfactory. Some candidates failed to explain how the shortage of materials would affect the time cost or monetary cost of land reclamation. Some others misinterpreted the given situation as implying that the government would choose to cancel the reclamation project or that there would be a drop in the value of reclaimed land, and then used that as the reason for a change in cost.
2(a)	Satisfactory. Some candidates mistakenly thought that Statement A is not a positive statement because the cash gift might not help to improve (i.e., have 'positive' effects on) the candidates' examination results. Some provided contradictory answers, saying that the statement is a positive one because it contains value judgment.
2(b)	Fair. Mis-reading the question, some candidates chose to discuss whether Statement B was positive or normative (rather than justifying it). There were also candidates who mistook the keyword 'justify' for 'evaluate' and went on to analyse whether the statement was correct. Some missed out the key terms such as 'equalising incomes/outputs' and 'equalising opportunities' in their discussion.
3	Fair. Quite a few candidates provided inaccurate examples, such as hospitals, post office, and water supply department. Some confused 'public corporation' with 'public limited company'.
4	Fair. Some candidates did not show a clear distinction between external benefits and external costs. Even among those who correctly pointed out that the vaccination gave rise to positive externality, some misunderstood that the external benefits arose from the absence of government subsidy on the public's vaccination. Candidates were generally weak in explaining the efficiency improvement after subsidy. Instead of explaining how the provision of subsidy would increase the number of people getting vaccinated toward the efficient level, they simply argued that the subsidy would help prevent the spread of flu and therefore narrow the gap between marginal social benefit and marginal social cost. The weaker candidates gave reasons unrelated to externality in their answers— such as labour productivity, health, shortage in medical services, or even inflationary gap.
5(a)	Good. Many candidates managed to identify the arrangement as a classic example of division of labour. A small number of candidates mis-read the question, and spent all the space explaining why division of labour was involved instead of what benefits it would bring. Some others provided irrelevant answers, such as the benefits of teaching multiple languages to the children.
5(b)	Satisfactory. Some candidates proposed concepts such as partnership, sharing economy, integration, and external economies, which are irrelevant to the given case. It showed that candidates have difficulties in applying simple economic concepts to real-life cases.
6(a)	Excellent. Only a minority of candidates mis-identified the situation as deflation.
6(b)	Fair. Many candidates correctly answered that Siu Keung would gain, but not everyone could explain their answers clearly. Problems in their explanation include: <ul style="list-style-type: none"> <li>- mixing up real and actual interest;</li> <li>- mixing up lenders and borrowers;</li> <li>- simply comparing the actual and expected inflation rates to explain Siu Keung's gain without discussing actual and expected real interest;</li> <li>- stating the increase in the real value of interest/money without using such keywords as 'received' or 'higher than expected'.</li> </ul>
6(c)	Satisfactory. Many candidates were able to compare correctly the percentage increase in nominal wage rate with the inflation rate in the corresponding year. However, some used the inflation rate in the wrong year for computing the percentage change in real wage.

Q. number	Performance in General
7(a)	Good. The only reminder for candidates is to present the answers in accurate units.
7(b)	Satisfactory. Some candidates mistook the maximum possible 'change' in money supply for the maximum 'level' of money supply. Others did not realise that the \$200 million cash would become reserves when the public no longer hold cash, and therefore got an incorrect answer.
8(a)(i)	Good. Some candidates failed to define absolute advantage properly in terms of an output-input relation— i.e., higher outputs for the same amount of inputs (resources). Others failed to support their arguments with their calculations.
8(a)(ii)	Excellent.
8(b)	Good. Common mistakes include: <ul style="list-style-type: none"> <li>- computing the per unit gain from trade without also computing the total gain (thus earning only partial credits);</li> <li>- calculating the per unit gain without specifying whether it is total gain or per unit gain (thus yielding no marks);</li> <li>- calculating the gain from trade for the car-exporting (rather than car-importing) country;</li> <li>- missing the units of measurement in their calculations/answers;</li> <li>- misconceiving that the question is about terms of trade.</li> </ul>

Section B

Q. number	Performance in General
9(a)	Good. Many candidates were able to identify the videos as public goods. In their elaboration, however, some showed limited understanding about the nature of public goods. For example, some candidates confused the 'non-rivalry in consumption' with the costliness of excluding non-payers from consuming the good.
9(b)	Good. Lateral expansion is an acceptable answer as candidates may consider products from Japan and Korea not being substitutable. Some candidates got the key features of different kinds of expansions mixed up. They erroneously related increase in market share to lateral expansion, and market diversification to horizontal expansion.
9(c)(d)	Good. Overlooking the keywords 'from the viewpoint of employer/employee', a minority of candidates came up with inaccurate answers. In discussing the low cost of supervision under piece-rate contracts, candidates should make it clear whether they are referring to the cost of monitoring (the quality of) output or monitoring workers' effort.
10(a)	Excellent. Most candidates were able to answer the question by drawing on the relation between tax rate and taxable income. Only a small number of them confused tax payment with tax rate.
10(b)	Good. Many candidates managed to explain logically how the tax reduction would increase AD and thus narrow/eliminate the deflationary gap. A small number of candidates had difficulty in indicating the deflationary gap on the diagram— either because they drew the LRAS curve in the wrong position OR because they mixed up deflationary gap with inflationary gap and deadweight loss.
10(c)	Fair. <p><u>Pros of the monetary policy:</u> Many candidates could point out that the decrease in RRR would increase money supply and lower the interest rate. Only some mentioned the possible increase in productivity (resulting from higher investment).</p> <p><u>Cons of the fiscal policy:</u> Many candidates stated that the drop in tax rate might reduce tax revenue. Some could further infer that this would worsen the fiscal balance.</p>

Q. number	Performance in General
	<p><u>Cons of the monetary policy:</u> Some candidates raised the possibility that banks might not lend out the excess reserves, so a reduction in RRR would not necessarily narrow the deflationary gap.</p> <p><u>Pros of fiscal policy:</u> Most candidates merely stated that the drop in average tax rate could help narrow the income gap. But only some of them reached their conclusion by examining its effects on both the low-income and high-income groups.</p>
11(a)	Excellent.
11(b)	Satisfactory. Some candidates failed to specify the condition for the existence of excess supply— i.e., price being set above its market-clearing (or equilibrium) level. Some mis-indicated the area of deadweight loss on the diagram. Others simply mentioned that marginal benefit (MB) was not equal to marginal cost (MC), without stating clearly that MB was greater than MC in this case.
11(c)	<p>Good. Common problems include:</p> <ul style="list-style-type: none"> <li>- failing to infer that RMB would depreciate against HKD as it depreciates against USD;</li> <li>- misconceiving that RMB would appreciate against HKD as it depreciates against USD;</li> <li>- mis-thinking that there is an increase in train fare in terms of HKD;</li> <li>- misconceiving that there would be an increase in demand (rather than quantity demanded) for tickets following the (HKD) price drop.</li> </ul>
12(a)(i)	Fair. Most candidates could illustrate how the imposition of tariff would affect the price and quantity of Chinese exports via an upward shift in the supply curve. Yet some of them overlooked the keyword 'net-of-tariff' and mis-focused on how the elasticity of demand would affect the total market value. Others mistakenly used a supply-demand diagram for the case of a small open economy to analyse the trade war between the two largest economies in the world.
12(a)(ii)	<p>Poor. The following problems were identified:</p> <ul style="list-style-type: none"> <li>- comparing wrongly the percentage changes in imports and exports rather than their absolute changes;</li> <li>- failing to spell out accurately the terms in international trade— examples include US's import to China, China's exports from the US, ...;</li> <li>- failing to use the information from Source A— and thus the elasticity of demand— as an explanation.</li> </ul>
12(b)	Satisfactory. Many candidates rightly concluded that the value of Hong Kong's re-exports would fall. They were able to point out that re-exports are positively related to total exports, though some failed to describe precisely their relation— i.e., total exports = domestic exports + re-exports. Some candidates misinterpreted the information from Source B; they mis-thought that columns 2 and 3 represented the re-exports values before and after the imposition of tariff respectively. Others misconceived that exports of China and Hong Kong were substitutes, and argued that a drop in the exports from China would result in an increase in the exports from Hong Kong.
12(c)	<p>Satisfactory. Most candidates were able to apply economic concepts and theories to deduce the effects of the tariffs on Hong Kong's aggregate output, tax revenue, and economic variables like unemployment rate, price level, trade balance, BOP, etc. However, only some of them managed to give a precise and logical explanation. Common problems include:</p> <ul style="list-style-type: none"> <li>- misconceiving that the plunge in the HSI means a drop in profits, or a loss, or a lower investment, reflecting their confusion between financial investment and real investment;</li> <li>- failing to mention wealth effect when discussing a reduction in consumption due to a stock-market crash;</li> <li>- failing to relate clearly changes in various types of incomes to corresponding changes in different types of tax revenues;</li> <li>- failing to use separate paragraphs for their discussion about different variables.</li> </ul>

## Section C

Q. number	Popularity	Performance in General
13(a)	54%	Good. Most candidates correctly stated the profit-maximising condition— i.e., marginal revenue (MR) = marginal cost (MC) — and then used it to find the relevant quantity; though some indicated the price in a wrong position. A minority of candidates wrongly drew the MR curve, mis-labelled the MR curve as AR curve, or replaced MR with the inaccurate term 'marginal benefit'.
13(b)(i)		Good. A minority of candidates misconceived the case as an upward shift of MC curve.
13(b)(ii)		Satisfactory. Most candidates were able to indicate correctly the deadweight loss (DWL) before the cost reduction, but only a few of them could represent the DWL after the cost reduction in an accurate manner. Among those who managed to draw the correct diagram, some mistakenly claimed that the gap between MB and MC was narrowed.
13(c)(i)		Good. A few candidates drew solely on the price difference (due to student discount) as evidence for price discrimination, without assuming absence of cost difference and product difference between smartphones sold to students and non-students.
13(c)(ii)		Satisfactory. Some candidates mis-interpreted the question as asking them to give another example of price discrimination. Others provided vague answers, such as 'elasticities are different', without mentioning the two sub-markets.
13(d)		Good. Most candidates correctly identified this kind of anti-competitive behavior as tie-in sales, and showed a good understanding of the potential harms that such behavior could cause to consumers. Yet a small number of candidates mistook this case for exclusive dealing.
14(a)	46%	Good. Many candidates were able to deduce that Country A would export Good X by computing its opportunity cost (in terms of Good Y) and then comparing it with the world price.
14(b)		Good. Many candidates managed to find the total gain from trade by drawing the consumption possibility curve and locating the after-trade consumption point. A common error was to either omit or mis-label the axes. Some simply mistook the export (or import) volume for the gain from trade.
14(c)		Satisfactory. Some candidates failed to indicate the import volume accurately.
14(d)		Satisfactory. Some candidates mistakenly stated that the fall in world price would necessarily lead to a change in the direction of trade.
14(e)		Good. Many candidates correctly stated that GDP growth would slow down, but only some of them could provide a proper explanation.
14(f)		Satisfactory. Some candidates ignored the focus of the question on why closed-door policy would worsen economic development (which includes the health and education dimensions of the HDI), and elaborated on the policy's effects on economic growth alone.

#### General comments and recommendations

1. Some candidates lacked 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 did not 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 had 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 lacked awareness of current economic issues in our society. Candidates should pay more attention to economic news.
5. Some candidates lacked 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.
6. Candidates should interpret carefully and properly use the sources provided in answering the data response question. They should use separate paragraphs for presenting different ideas in their answers.

#### Acknowledgements

The following material has been used in question papers in this volume:

- |                          |   |
|--------------------------|---|
| South China Morning Post | As dengue fever scare hits Hong Kong, how can you best avoid infection?<br><a href="https://www.scmp.com/news/hong-kong/health-environment/article/2160887/dengue-fever-scare-hits-hong-kong-how-can-you-best">https://www.scmp.com/news/hong-kong/health-environment/article/2160887/dengue-fever-scare-hits-hong-kong-how-can-you-best</a>  |
| The Legislative Council  | Trade conflict between China and the United States and its impact on Hong Kong's economy<br><a href="https://www.legco.gov.hk/research-publications/english/1718in14-trade-conflict-between-china-and-the-united-states-and-its-impact-on-hong-kongs-economy-20180717-e.pdf">https://www.legco.gov.hk/research-publications/english/1718in14-trade-conflict-between-china-and-the-united-states-and-its-impact-on-hong-kongs-economy-20180717-e.pdf</a> |

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