Marking Schemes

Paper 1

Question No.	Key	Question No.	Key
1.	C (76)	21.	A (22)
2.	C (74)	22.	A (60)
3.	D (45)	23.	D (76)
4.	B (82)	24.	B (65)
5.	C (71)	25.	B (41)
6.	D (55)	26.	C (58)
7.	D (83)	27.	B (67)
8.	A (82)	28.	B (43)
9.	A (84)	29.	A (56)
10.	D (60)	30.	D (59)
11.	B (87)	31.	B (45)
12.	A (25)	32.	B (74)
13.	B (63)	33.	A (91)
14.	C (41)	34.	C (82)
15.	D (54)	35.	A (70)
16.	A (46)	36.	C (80)
17.	D (40)	37.	D (52)
18.	A (52)	38.	A (50)
19.	B (59)	39.	A (64)
20.	D (69)	40.	C (70)

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

1. Reasons:
   - Sellers provide heterogeneous services, e.g. different tour groups.
   - Market information is imperfect, e.g. information about routes and services.
   - Sellers engage in both price and non-price competition, e.g. advertisements.
   - any other relevant point

   [Mark the FIRST TWO points only.]

   @ 2; max: 4

2. (a) Private property rights refer to the exclusive right to use, the exclusive right to receive income from, and the right to transfer a property owned by an individual.
   The private property rights over the flats under the scheme are weakened as the flat-owners' right of selling (or transferring) their flats to non-residents is confined. (4)

   (b) Price will be lower because the number of potential buyers will drop resulting in a lower demand for these flats. (3)

3. (a) Nominal interest rate (R) = expected inflation rate + real interest rate (r) (2)

   (b) No, R will be lower than r only when the expected inflation rate is negative. But the existence of actual deflation does not imply that the deflation is expected. (3)
   OR
   Yes, because people may expect deflation beforehand and an expected deflation will result in a nominal interest rate being lower than real interest rate. (3)
   OR
   Yes, because the realized (actual) real interest rate will be higher than the nominal interest rate when there is actual deflation. (3)

   Any one max: 3

4. (a) *Wealth effect*: As many of the assets in the economy are denominated in nominal values, the higher the price level, the lower the purchasing power of money. This reduces the wealth of the economy (in real terms). As a result, households and firms reduce their purchases of all goods and services and the real output drops.

    (3)

    Interest rate effect: As the price level rises, households and firms demand more money to finance their transactions. Given the fixed supply of money, the interest rate would rise. An increase in interest rate would cause decline in investment and consumption and also the real output.

    (3)

    Net exports effect: As the domestic price level rises, foreign-made goods become relatively cheaper so the quantity demanded of imports increases. However, the rise in the domestic price level also means that domestic-made goods are relatively more expensive to foreign buyers so the quantity demanded of exports decreases. When the volumes of exports decrease and of imports increase, net exports will decrease (if the price-elasticities of demand for exports and/or imports are sufficiently high). Because net exports are a component of real GDP, the demand for real GDP declines as net exports decline.

    (3)

    Any one max: 3

    (b) Verbal elaboration:
    Increase in the price of raw materials results in a rise in factor prices. So the SRAS will decrease. Price level increases and the output will fall in the short run. The resulting excess supply of labour / deflationary (output) gap will result in a downward pressure on the input prices. In the long run, wages will adjust downward and the SRAS will increase and the price level will fall back to the original level.
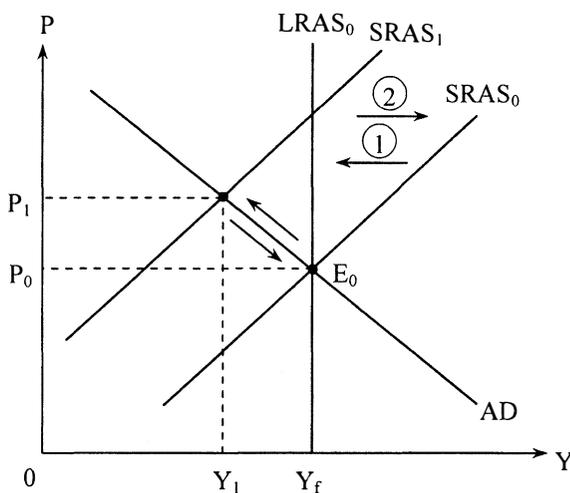
    (5)

    Indicate on the diagram:
    – SRAS shifts to the left   (1)
    – P increases, Y drops   (1)
    – SRAS shifts back to the original position   (1)
    – final fall in P, back to the original level   (1)

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5. (a) In Country A, the opportunity cost of producing 1 smartphone (S) = 0.75 Food (F)   (3)
   In Country B, the opportunity cost of producing 1 smartphone (S) = 0.5 Food (F)
   Country B has a comparative advantage in producing smartphones.

   (b) Yes, because the potential gain from trade (0.75F-0.5F=0.25F) per unit of   (3)
   smartphones is greater than the transportation cost (0.2F).

6. (a) Balance of current account = 35-50+47-27 = $5million   (1)

   (b) No, because the BOP balance is -$10million, which implies a BOP deficit.   (3)

7. (a) Construction.   (1)
   This is because the entry to a particular occupation is closely associated with a   (2)
   person's human capital, which tends to be more homogeneous among the
   construction workers than among finance professionals.

   The construction industry often pays their workers by time rates, which are more or   (2)
   less uniform across workers. In addition to basic salaries, compensations to the
   employees of financing, insurance, real estate and business services often include
   performance-based commissions, bonuses and profit-sharing, which may result in a
   greater diversity of income within this industry.

   max: 3

   (b) The Gini coefficient, which reflects the degree of income inequality, has increased   (1)
   in the HK economy as a whole.

   Possible reasons:
   – As shown in Table 1, income inequality in both the construction and   (2)
   financing, insurance, real estate and business services industries has
   increased. Other things being equal, this would contribute to the increase in
   the income inequality in the entire economy.

   – As shown in Table 2, there is an increase in the proportion of working   (2)
   population in the industry with a larger disparity of income (i.e. financing,
   insurance, real estate and business services) and a decrease in the industry
   with a smaller disparity of income (i.e. construction). Other things being
   equal, this changing pattern of employment distribution across the two
   industries would contribute to the increase in the income inequality in the
   entire economy.

   max: 3

8. Government should increase the income tax rate to reduce the budget deficit:
   - if the increase in tax revenue due to the rise in tax rate outweighs the reduction in tax payment due to the reduction in the tax base/taxable income (e.g., a fall in the number of tax payers as a result of disincentive effects to labour). (4)
   - because increase in tax rate is fairer as income tax is often proportional (or even progressive) and this helps equalize income. (2)
   - if there is an inflationary (output) gap as an increase in income tax reduces output and relieves the inflationary pressure. (2)
   - any other relevant point

   Government should not increase the income tax rate to reduce the budget deficit
   - if the increase in tax revenue due to the rise in tax rate falls short of the reduction in tax payment due to the reduction in the tax base/taxable income (e.g., a fall taxable income as a result of reduction in aggregate output). (4)
   - because an increase in income tax rate will result in a greater disincentive to work and more people may quit the job and rely on welfare programmes and this further worsen the budget deficits. (2)
   - as an increase in income tax rate reduces the aggregate output, which may result in unemployment / deflationary (income) gap. (2)
   - any other relevant point

   max: 4

9. (a) Verbal elaboration:
   If the demand for MTR service is inelastic, the percentage increase in fare will be higher than the percentage decrease in the number of trips, so the total expenditure will increase. (3)

   Indicate on the diagram:
   - correct position of gain and loss (1)
   - gain > loss (1)
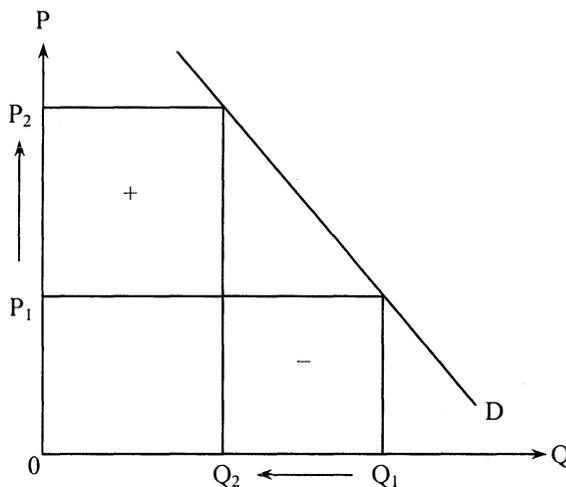
   (b) No, as the provision of MTR service involves the use of scarce resources having alternative uses. (2)

   (c) No, as people have different alternative uses of time, their time costs will not be the same. (3)

10. (a) Division of labour   (1)
   - choosing the most suitable person for the job
   - practice makes perfect
   - saving time in training   @1
   - stimulus to mechanisation   max: 3
   - Any other relevant point

   [Mark the FIRST THREE points only.]

   (b) (i)   –   It improves the work incentive of the manager.
          –   any other relevant point   @2

   [Mark the FIRST point only.]   max: 2

   (ii)   –   It gives a more stable income as the manager still receives a basic salary even if the business is poor.   @2
          –   any other relevant point   max: 2

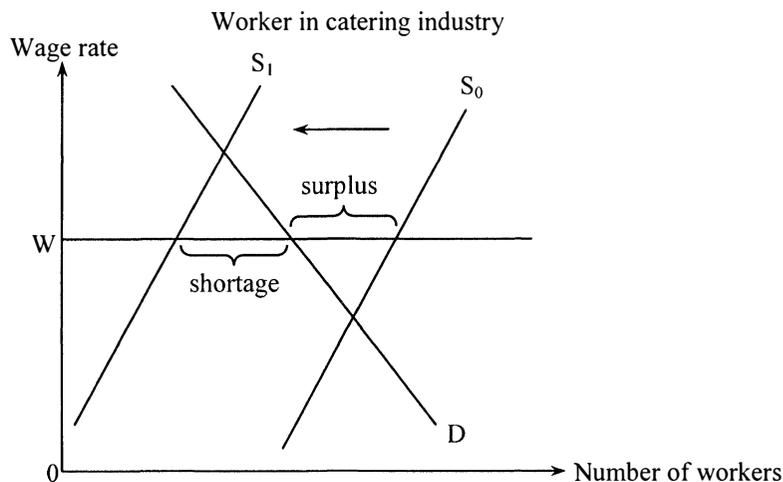   [Mark the FIRST point only.]

   (c) <u>Verbal elaboration:</u>
   An effective price floor will create a surplus of workers. If the restaurant workers change to work in other industries (for example, turn into security guards) the supply of workers in this industry drops, there may be a shortage for workers at the minimum wage rate.   (4)

   <u>Indicate on the diagram:</u>
   - wage rate set above the original equilibrium   (1)
   - surplus   (1)
   - magnitude of the leftward shift of the supply curve greater than the surplus   (2)
   - final shortage   (1)

Worker in catering industry

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11. (a) Objective (1): Yes, as it provides cash subsidies relieving the burden on travelling expenses. (2)

        Objective (2): Yes, if the WITSS continues to subsidize the workers on travelling expenses. (2)

        OR

        Objective (2): No, as employment (as well as unemployment) largely depends on the aggregate demand and supply of the economy (which may fluctuate over time) rather than the WITSS. (2)

                                                                                               max:2

(b) (i) It increases the geographical mobility as workers are more willing to travel to other districts for work. [1] (3)

   (ii) It helps to reduce the income inequality. It helps equalize outcome as it provides extra money for the lower-income group only / it increases their opportunity of finding a job with higher income because they can travel farther away from their residential area. (3)

   (iii) The effect on the unemployment rate is uncertain. The size of the labour force would increase as more people originally outside the labour force are induced to look for jobs. But the total number of unemployed may also increase as some of these new workers may fail to get a job. The resulting rate of unemployment depends on the percentage increase in the unemployed population relative to that in the labour force. (3)

[1]The lump-sum subsidy will not change the marginal cost of travelling. But some of the workers originally constrained by high travelling expenses may have the incentive to travel further for work (for a higher paid job).

12. (a) Monetary base = $400 million + $1000 million = $1400 million   (2)
        Money supply = $1000 million + $2000 million = $3000 million   (2)

    (b) New money supply
        = $1000 million + $400 million × 1/25% = $2600 million   (2)

    (c) <u>Verbal elaboration:</u>
        An upward adjustment of required reserve ratio reduces the money supply,   (5)
        resulting in an increase in interest rate and a drop in investment expenditure. The
        aggregate demand will fall, and so will the price level and output level.

        <u>Indicate on the diagram:</u>
        –   AD shifts to the left   (1)
        –   price level falls   (1)
   –   output level falls   (1)

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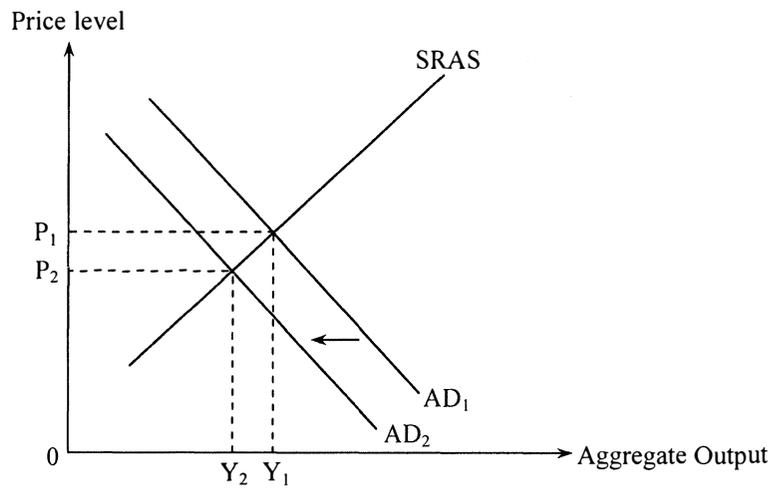
13. (a) <u>Verbal elaboration:</u>
The monopolist has a constant marginal cost of production. It will produce at the output level where marginal revenue equals marginal cost in order to maximize profit. At this output level, marginal benefit is greater than marginal cost and there is a deadweight loss. (3)

<u>Indicate on the diagram:</u>
- Correct position of marginal revenue (1)
- Constant marginal cost (1)
- Correct position of P and Q (1)
- Correct position of Deadweight Loss (1)
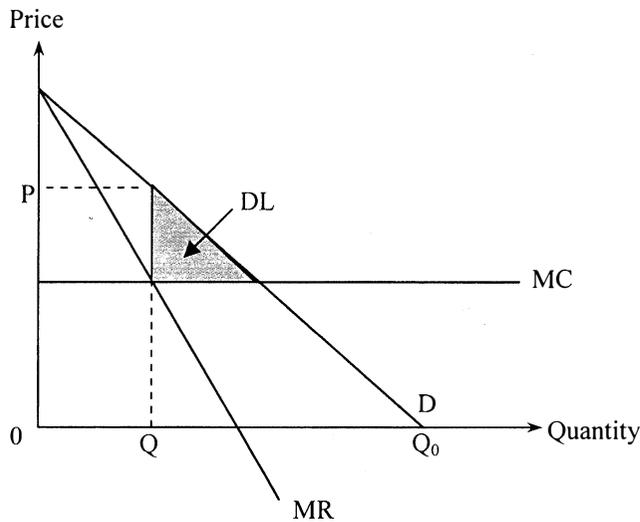
(b) Yes. This is because the seller is selling the same product produced at the same cost to different people (tourists and locals) at different prices produced at the same cost. (3)

(c) (i) Resale price maintenance. This reduces price competition among retailers. (2)

(ii) Predatory pricing. This aims to drive out competitors. (2)

(d) – Administrative costs may be high
– Higher cost of production
– Other measures can be used to promote competition
– Market is competitive and government intervention is not necessary
– any other relevant point

@2;
Max: 2

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14. (a) (i) Country A will import Good Y because the domestic production cost of Good Y is higher than the terms of trade. (2)

(ii) <u>Indicate on the diagram:</u>
Correct position of PPF (1)
Correct position of CPF (1)

Good Y (units)

10

CPF

4 PPF

0
10 Good X (units)
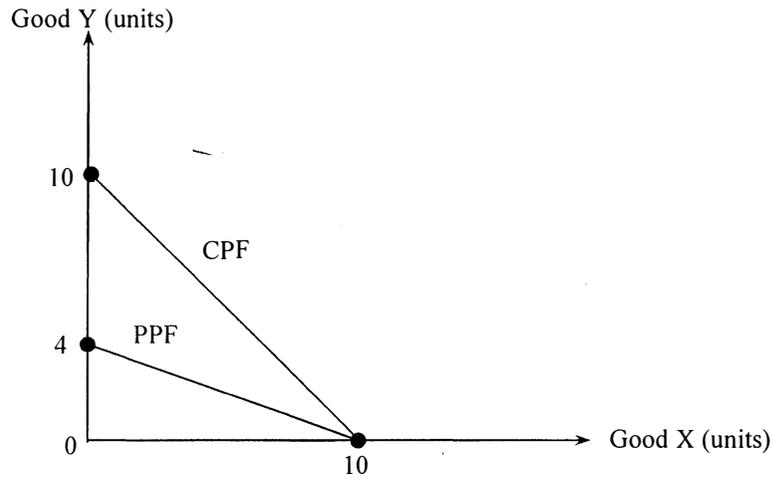
(iii) Country A will still import Good Y because the domestic production cost of Good Y is still higher than the terms of trade. Country A will be better off as the CPF shifts outward / Country A can consume more of Good X and Good Y. (4)

<u>Indicate on the diagram</u>
Correct position of PPF (1)
Correct position of CPF (1)

Good Y (units)

20

CPF

PPF
8

0
20 Good X (units)
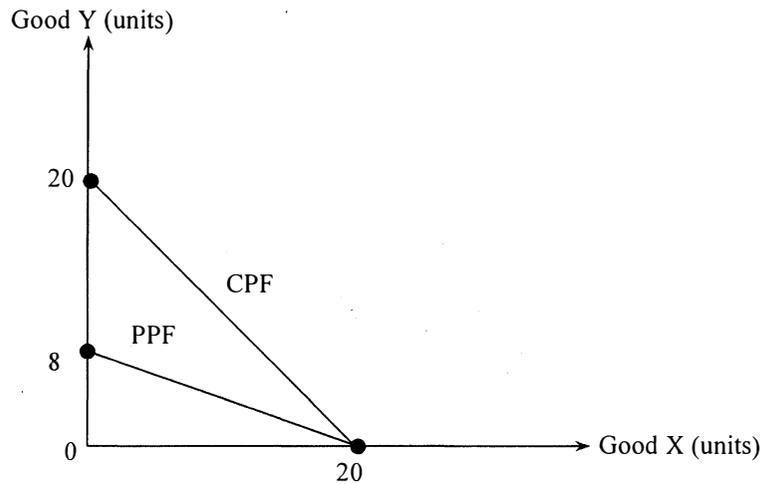
(b) (i) Hong Kong. (2)
Hong Kong: GNI per capita rank – HDI rank = –4,
Given HDI rank = 13, GNI per capita rank = 9
Japan: GNI per capita rank – HDI rank = 11,
Given HDI rank = 12, GNI per capita rank = 23

(ii) – Japanese have longer years of schooling on average. (2)
– Japanese have a longer life expectancy on average.
[Mark the FIRST TWO points only.]

(iii) Any example of policy that can enhance the education level or health (2)
condition of Hong Kong people. E.g., increase government subsidy on
tertiary education.