2013 DSE Economics

Candidates' Performance

Paper 1

Candidates' performance was generally good. The mean score of this paper is 25 out of 40. The following questions deserve special attention.

Q.12   A drop in the price for good X will lead to a drop in the price of good Y if

    (1)   good X and good Y are substitutes.
    (2)   good X and good Y are complements.
    (3)   good X and good Y are in competitive supply.
    (4)   good X and good Y are in joint supply.

*A.	(1) and (3) only	(24%)
B.	(1) and (4) only	(15%)
C.	(2) and (3) only	(10%)
D.	(2) and (4) only	(51%)

This question examines the effect of an exogenous change in the price of one good on the market of a related good. Many candidates were not able to make proper use of the concepts of substitutes, complements, competitive supply and joint supply to deduce the effect on the demand/supply of a related good.

Q.17   The market structure of the electric power industry in Hong Kong is

A.	an oligopoly because there are two dominating companies in the market.	(37%)
B.	an oligopoly because the pricing strategies of the companies are interdependent.	(7%)
C.	a monopoly because the companies can increase the price without losing customers.	(16%)
*D.	a monopoly because there is only one electric company providing electricity in any district.	(40%)

This question tests the application of knowledge about market structure in the Hong Kong economy. Many candidates did not recognize that although there are two dominant electric power companies in Hong Kong, their markets are separated and there is only a single electricity provider in any given district.

Q.21 Which of the following items is **NOT** included in the calculation of Hong Kong's net factor income from abroad for the current year?

    *A.   the income received by a Japanese teacher who worked in a   (22%)
            language school in Hong Kong for one year

    B.   rental income earned from real estate holdings in Canada owned   (13%)
            by a Hong Kong resident

    C.   salary received by an Indian consultant who worked for the   (28%)
            Hong Kong Airport Authority for three months

    D.   dividends earned from shares in Hong Kong held by a US resident   (37%)

This question is about national income accounting. Candidates should pay more attention to items which are included in or excluded from the net factor income from abroad. Many of them failed to realise that salary, rental income and dividends are considered returns to factors of production. A foreigner working in Hong Kong for one year is treated as a local resident, so his (factor) income is not counted as foreign income.

Q.25 Which of the following is included in the money supply M2?

(1)   legal tender held by licensed banks
(2)   demand deposits with licensed banks
(3)   time deposits with restricted licence banks
(4)   negotiable certificates of deposit issued by licensed banks held by the non-bank public

    A.   (2) and (3) only   (10%)
*B.   (2) and (4) only   (41%)
    C.   (1), (2) and (4) only   (43%)
    D.   (1), (3) and (4) only   (6%)

Many candidates were confused about the difference between monetary base and money supply. Quite a few of them included legal tender held by licensed banks as an item under money supply. While cash in public circulation is an item under "money supply," cash held by licensed banks should be classified under "monetary base".

Q.28 An expansionary monetary policy is adopted in China when

(1)   the Ministry of Finance (財政部) provides cash subsidies to agricultural workers.
(2)   the People's Bank of China (中國人民銀行) reduces the required reserve ratio of all commercial banks.
(3)   the Bank of China lowers its lending rate to small and medium-sized enterprises.

    A.   (1) only   (9%)
*B.   (2) only   (43%)
    C.   (3) only   (6%)
    D.   (1), (2) and (3)   (42%)

This question is about how to conduct monetary expansion in China. Many candidates mis-conceived any government action leading to a rise in national output as expansionary monetary policy. They should understand that only the use of tools by the central bank that results in an increase in money supply and/or a fall in the interest rate—aiming at (but not necessarily effective in) raising national output—can be considered expansionary monetary policy. Both actions (1) and (3) cannot be viewed as monetary policy. Action (1) is an example of expansionary fiscal policy, while action (3) may not even be regarded as a government policy (given that the Bank of China is not China's central bank).

Paper 2

Section A

Q. number	Performance in General
1	Excellent. Most candidates gave good reasons, and some could even cite relevant real-life examples to support their answers. A few candidates failed to elaborate their answers or relate them to the case in the question when explaining imperfect information in the market.
2(a)	Good. Most candidates were able to give an accurate definition of private property rights. Some missed the key word "exclusive", though.
2(b)	Fair. While most candidates were able to relate the change in price to a change in demand, some did not explain why demand for the flats drops. Some wrongly focused their analyses on the flats without the reselling restriction, but did not consider those with the restriction.
3(a)	Good. Some candidates omitted the important word "expected".
3(b)	Poor. The gist of the question is whether or not deflation is expected. The majority of candidates presented vague arguments, mixing up expected (*ex ante*) and actual (*ex post*) interest rates.
4(a)	Good. Most candidates gave a good reason with clear logic. Some failed to illustrate the role of wealth in the wealth effect; they were not able to explain why an increase in the price level leads to a drop in consumption via a reduction in wealth.
4(b)	Good. The majority of candidates gave a clear and complete analysis diagrammatically and verbally. Some failed to show that long-run adjustment involves a rightward shift in the SRAS curve. Others mis-associated excess demand for labour with output below its full-employment level.
5(a)	Excellent. Only a minority of candidates failed to express their answers in proper units.
5(b)	Fair. Some candidates did not re-compute opportunity costs by incorporating the transportation cost. Instead, they simply used the terms of trade to address the question and thus failed to deduce the correct answer.
6(a)	Fair. The following are common mistakes: – wrong inclusion of capital flows (whether inflows or outflows) in the calculation of current account balance; – mixing up the BOP and current account balance; – failure to specify the unit of measurement.
6(b)	Poor. The majority of candidates misinterpreted the $10 million credit in foreign exchange and reserve assets as an increase in reserves. They failed to demonstrate an understanding of the mechanism under which a BOP deficit causes an outflow of foreign reserves.
7(a)	Fair. The majority of candidates made use of the information provided by Table 1 to explain the difference in income inequality between occupations. Common mistakes include: – overlooking the key word "occupation" and comparing instead the income inequality across years; – discussing merely the meaning of Gini-coefficient without actually addressing the question; – mixing the concept of income inequality with that of income instability.

Q. number	Performance in General
7(b)	Poor. This question is demanding as it requires interpretation of data from several tables. The data in Tables 1 and 3 are extracted from the results of the population census and by-census while those in Table 2 are extracted from Hong Kong in Figures 2012 Edition. Although there are differences in the data coverage and industry classification for the statistics extracted from these two sources, the question aims to examine candidates' in-depth understanding of the concept of "income equality" as well as the ability to infer possible reasons for the increasing income equality of Hong Kong from simplified data. The majority of candidates were able to point out that income inequality has increased but failed to make good use of the given data in their explanations. Some candidates misinterpreted the percentage distribution of employment across industries as their employment populations, and thus wrongly regarded a rise in the figures for a certain industry as an increase in the number of (employed) workers in that industry.
8	Fair. The majority of candidates managed to provide a decent evaluation of whether the policy can achieve its objectives. Some common mistakes are as follows: – failure to support their stands with proper arguments, or merely writing down a "yes" or a "no" without explanation; – poor organization of answers and contradictory arguments; – provision of counter-proposals instead of evaluation of the proposal given in the question; – mis-thinking that a rise in tax rate will necessarily lead to an increase in tax revenue without considering the disincentive effect of the tax-rate increase on income and consumption; – mixing up the concepts of taxable income and disposable income.

Section B

Q. number	Performance in General
9(a)	Excellent. Most candidates could illustrate their answers with a well-labelled diagram.
9(b)	Excellent. Most candidates gave good reasons to explain why the journey is not a free good. A minority of candidates mistook the cost of using the ticket as the cost of "producing" the ride.
9(c)	Good. Some candidates failed to apply the concept of time cost in their explanations.
10(a)	Excellent.
10(b)(i)	Good. A minority of candidates overlooked the key words "from the viewpoint of the restaurant owner" and gave irrelevant answers as a result.
10(b)(ii)	Satisfactory. Some candidates did not analyse the problem from the perspective of the manager. Others failed to recognise that the bonus could contribute to the profit of the restaurant by boosting the manager's work incentive.
10(c)	Poor. Although the majority of candidates were able to use a demand-supply diagram to illustrate the concepts of price floor and worker surplus, only a few of them could explain correctly how demand or supply changes accordingly to create "a shortage under a price floor". The following are some common mistakes: – misinterpretation of minimum wage as a price ceiling; – wrong configuration of an effective minimum wage as a wage set *below* the market-clearing wage in order to generate a shortage of labour; – mis-equating unemployment with labour shortage.

4

Q. number	Performance in General
11(a)	Fair. The majority of candidates were able to point out that the scheme is a subsidy to workers to relieve their burden of transportation expenses and that the subsidy results in a greater incentive for job-seekers to seek jobs. Some candidates failed to state clearly which objective they were referring to, resulting in confusing answers. Some others overlooked the word "sustained" or mis-thought that the scheme would increase work incentives.
11(b)(i)	Satisfactory. Although most candidates were able to provide a good analysis of the policy effects on labour mobility, some of them failed to indicate clearly which kind of mobility—geographical or occupational—they were talking about. A few of them mixed up the two kinds of mobility, so their answers and illustrations did not match each other.
11(b)(ii)	Satisfactory. The majority of candidates were able to point out that some households in the lower-income group could benefit from the scheme. In their elaborations, some brighter candidates could even distinguish the concept of "equalizing income" from that of "equalizing opportunities". A common problem, however, is that there was an over-emphasis on the poor in candidates' discussions, without mentioning how the policy would affect the rich.
11(b)(iii)	Poor. Although most candidates were able to point out that more workers would go out to seek jobs, they failed to provide a comprehensive analysis of the possible effects of the policy on the unemployed and the labour force. Common mistakes include: – failure to use the unemployment-rate formula; – mixing up the concepts of "labour supply" and "labour force"; – mis-assuming that people who want to seek a job will necessarily get one; – over-emphasizing the effect of the scheme on the number of unemployed while ignoring its possible effect on the size of the workforce.
12(a)	Good. A minority of candidates did not understand the concept of monetary base. Some expressed their answers in wrong units.
12(b)	Excellent. A few candidates carelessly stated their answers in terms of the change in money supply rather than the new level of money supply.
12(c)	Satisfactory. The majority of candidates were able to draw a well-labelled diagram and give a clear explanation about the effects of such a contractionary monetary policy. The following contains a list of common mistakes: – mis-thinking that a change in money supply will affect disposable income directly; – mis-representing a drop in money supply as a drop in short-run aggregate supply; – mis-labelling the vertical axis of the AD-AS diagram as money or price instead of the price level; – failure to provide a step-by-step analysis of how a change in money supply would affect AD (e.g., omitting the step that a rise in the interest rate will follow as a result of a reduction in money supply).

Section C

Q. number	Popularity	Performance in General
13(a)	57%	Good. The most common mistake is drawing an upward-sloping marginal cost curve instead of a horizontal one. In their discussions, a minority of candidates mis-specified the "marginal cost = marginal revenue" condition as "marginal cost = marginal benefit".
13(b)		Good. Most candidates showed a good understanding of "what constitutes price discrimination" and were able to apply the concept in the given case. A few candidates failed to distinguish between the tourists and the locals as two separate groups of customers.
13(c)(i)(ii)		Satisfactory. Most candidates were well aware of how the described behaviour restrains competition in each case, but some of them were unable to name the behaviour.
13(d)		Satisfactory. Some candidates misunderstood the key word "concern" and explained the advantages of introducing a competition policy.
14(a)(i)(ii)	43%	Good. Most candidates were able to make use of the given data to determine which good country A does not enjoy a comparative advantage in producing. But some candidates did not mark the intercepts of the production - and consumption - possibility curves, resulting in incomplete answers.
14(a)(iii)		Satisfactory. Those candidates who could construct accurately the production - and consumption - possibility curves were usually able to explain logically the resulting directions of trade and the potential gains from trade. Some candidates failed to interpret the key words "better off" and gave irrelevant answers.
14(b)(i)(ii) (iii)		Good. A common mistake is that candidates took a smaller number in the "ranking" as a smaller GNI.

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 incorrect 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.