

Candidates' Performance

Paper 1

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

4. Because of COVID-19, normal schooling was disrupted. Most schools used video communication software, such as Zoom and Google Meet, to conduct online lessons. Suppose the school campus was re-opened and face-to-face lessons were allowed.

Which of the following would be the LEAST important factor for teachers to choose between online lessons and face-to-face lessons?

- A. The risk of contracting COVID-19 for teachers is lower when they conduct online lessons. (2%)
- B. Teachers have no idea what their students are doing during online lessons because students may turn off their cameras. (17%)
- *C. Teachers have already spent a lot of time learning how to use the video communication software to conduct online lessons. (60%)
- D. The eyesight of teachers may be worsened by the intensive use of the video communication software in conducting online lessons. (21%)

This question examines candidates' understanding of the role of sunk cost in making choices. Resources already spent on production in the past (which are unrecoverable) would not affect decision-making in the current and future periods. Time spent on learning video communication software is a bygone, and therefore should not affect the benefits and/or costs of conducting online lessons relative to face-to-face lessons. On the other hand, Option A and Option D are important as they may affect the health of teachers, while Option B also matters as it would reduce the effectiveness of teaching.

10. Because of the outbreak of COVID-19, the government of a country announced a temporary ban of dine-in services in restaurants. Which of the following statements about restaurants under the temporary ban is correct?

- *A. If the expected sales revenue generated from takeaway food exceeds the variable cost of running a restaurant, the restaurant will continue to operate. (46%)
- B. With the extremely high cost of breaking the rental contract, the fixed rental will affect whether the owners continue to operate their restaurants. (33%)
- C. A decrease in prices of takeaway food will necessarily decrease the sales revenue of the restaurants. (5%)
- D. Unpopular restaurants will close down before popular ones. (16%)

This question is related to fixed cost and variable cost. 'Revenue exceeding total variable cost' implies that at least part of the fixed cost can be covered, so the firm should continue its operation in the short run [i.e. Option A]. Regarding Option B, the fixed rental would be avoidable if the restaurant owners could break the rental contract (with possibly some compensation to the landlord) or sell their restaurants outright. But the question assumes that the cost of breaching the rental contract is prohibitively high, so this is not a viable option. Under the pandemic situation, it would also be difficult to sell one's business (even at fire-sale prices). What it means then is that the restaurant owners have no choice but to pay the rental as a fixed cost and continue to operate their restaurants (unless their sales revenues cannot cover their variable costs).

29. The outbreak of COVID-19 results in a significant decline in employment level and the volume of exports of a country.

Which of the following policies can most likely relieve the above two problems?

- | | | |
|-----|---|-------|
| A. | The central bank reduces the discount rate. | (14%) |
| B. | The government distributes cash to citizens aged 18 years old or above. | (4%) |
| C. | The government imposes 'employment support scheme' to industries that are adversely affected. | (43%) |
| *D. | The country devalues its currency against the currencies of its major trading partners | (39%) |

This question considers the negative effects of COVID-19 on an economy and remedial policies. The 'employment support scheme' under Option C is an attempt to relieve the unemployment problem via subsidies to the employers, but its effect on exports is not obvious. On the other hand, the currency devaluation under Option D would improve the competitiveness of its export goods, thus increasing aggregate demand and labour employment as well.¹

41. Mr Li is a major shareholder of a Hong Kong listed company which makes huge profits. He has sold some of his residential properties, and received rental income from some leased commercial buildings.

According to the above information, which types of tax does Mr Li need to pay to the Hong Kong government?

- (1) profits tax
(2) stamp duty
(3) property tax

- | | | |
|-----|------------------|-------|
| A. | (1) and (2) only | (9%) |
| B. | (1) and (3) only | (31%) |
| *C. | (2) and (3) only | (26%) |
| D. | (1), (2) and (3) | (34%) |

The question examines candidates' understanding of taxation in Hong Kong. It is quite obvious that Mr Li's rental income is subject to property tax (Item #3). Any property transaction is subject to stamp duty (Item #2), and both the buyer and the seller are liable for the tax - so Mr Li has to pay stamp duty as well.² The major distractor in this question is profits tax (Item #1). Quite a few candidates did not realise that it is the company (as a legal entity), rather than the shareholder, which pays the profits tax - so Mr Li is exempt from such tax.

¹ For simplicity, we assume here that foreign demand for the country's exports is sufficiently elastic or, more generally, that the Marshall-Lerner condition holds.

² As an indirect tax, the burden of the stamp duty would usually be shifted to the buyers (specified in the provisional or formal sale and purchase agreement). But candidates are not expected to know the details in property sale and purchase contracts.

42. Refer to the following statistical data about Hong Kong.

	2020 first quarter (year-on-year change)	2020 second quarter (year-on-year change)
Exports of goods	-9.7%	-2.5%
Exports of services	-37.5%	-47.5%
Imports of goods	-10.7%	-7.4%
Imports of services	-26.2%	-44.6%

Based on the above information, we can conclude that

- A. Hong Kong had an invisible trade deficit in 2020 second quarter. (24%)
- B. Hong Kong's net exports in 2020 second quarter was lower than that in 2019 second quarter. (13%)
- C. Hong Kong's exports of goods in 2020 second quarter was lower than that in 2020 first quarter. (34%)
- *D. Hong Kong's total imports of goods and services in 2020 second quarter was lower than that in 2019 second quarter. (29%)

This question requires interpretation of trade data. As the values of exports and imports of goods and services in 2019 are not provided, we cannot tell whether there was initially a surplus or deficit in the (visible as well as invisible) trade balance or whether net exports were initially positive or negative, and thus cannot conclude how these variables would perform in 2020. Hence, both Option A and Option B may not be correct. Since the percentage changes in the four variables reported in the table are year-on-year rather than quarter-on-quarter,³ they cannot be used to compare '2020 second quarter' with '2020 first quarter' - implying that Option C may not be correct as well. Option D is the correct answer, as the table shows that imports of goods and services had dropped by 52% ($=7.4\%+44.6\%$) in the second quarter of 2020 relative to the second quarter of 2019.

³ Year-on-year changes are usually used for comparison to avoid seasonal fluctuations of economic variables.

Paper 2

Section A

Q. number	Performance in General
1(a)	Good. Most candidates were able to use the information provided and apply their textbook knowledge about wage payment arrangement to answer the question.
1(b)	Excellent.
1(c)	Good. Most candidates were able to state the law of diminishing returns correctly. But some candidates either mis-named the law or failed to provide an example of fixed factor in this case. Candidates who performed worse on this item tended to mix up variable factors with variable costs.
2	Satisfactory. Many candidates did realise that relative price is the key concept in this question. However, some candidates failed to compare correctly the 'relative prices between long-distance trips and short-distance trips' before and after the surcharge. Many mistakenly stated that the relative price of long-distance trips would be lower than that of short-distance trips, while some wrongly concluded that the quantity demanded of long-distance trips (rather than the average travel distance) would rise after the addition of the surcharge.
3	Satisfactory. Many candidates were able to identify the type of integration concerned and list the features accordingly. A few candidates seemed to be confused about the relation between the airline and air-catering in this case and mistook it for 'conglomerate integration'.
4	Good. Some candidates simply described the characteristics of an oligopoly (e.g. imperfect information) without relating their answers to the smartphone market. A few candidates mis-asserted that price competition does not exist in perfectly competitive markets.
5(a)(i)	Satisfactory. Most candidates stated correctly that Mr Chan's income from the UK would not be included in HK's GDP, but some of them failed to give a proper explanation. Some candidates mis-regarded Mr Chan (the employee) rather than the UK football club (the employer) as the non-resident producing unit (from HK's perspective).
5(a)(ii)	Satisfactory. Some candidates used the terms 'people' or 'citizens' instead of residents in their answers - which is not precise for the purpose of national-income accounting. Other candidates mixed up the concepts of 'resident' and 'resident producing unit'. Some failed to state clearly that Mr Chan's salary was an inflow of factor income from abroad.
5(b)	Good. Many candidates managed to apply their knowledge about money and foreign exchange to justify their choices with proper economic reasons. A few candidates picked GBP based on the erroneous argument that, by such choice of currency denomination, Mr Chan would be able to earn more income when converted to HKD because GBP has a higher per-unit value than USD in terms of HKD. A minor few carelessly put down 1 HKD = 7.8 USD under the linked exchange rate.
6(a)	Excellent. Most candidates were able to make use of the information about total reserves and excess reserves as well as deposits to compute the correct answer. Among those who failed to do so, most of them overlooked the excess reserves of \$300 million. As it turned out, candidates' performance was not affected by the typo on the balance sheet.
6(b)	Good. Some candidates mixed up the formula of 'change in deposit' and 'total amount of deposit created' and obtained an incorrect answer. A few candidates who chose to show their workings by using a single formula made mistakes and lost track of their calculations. Candidates are advised to break down their calculations in multiple steps so as to enable themselves to identify any computational errors more easily.
7	<p>Good. The following is a list of some common errors.</p> <ul style="list-style-type: none"> • Listing the functions of money (e.g. store of value) or characteristics of good money (e.g. durable, homogenous) without relating their answers to the case of cigarettes. • Ignoring the 'apart from' clause of the question and mis-stating 'not being generally acceptable' as their answers.

Q. number	Performance in General
	<ul style="list-style-type: none"> • Not quite accurate elaboration on the 'non-divisible' property of cigarettes. • Misunderstanding that cigarettes are not a good form of money because they are not scarce in the society.
8	Good.
9(a)	Satisfactory. Some candidates failed to relate the definition of inferior good to the recession.
9(b)	Poor. Ignoring the assumption of a small open economy, many candidates drew a vertical supply curve for junk food. Some candidates neglected the possibility that the recession would cause a rightward shift of demand curve for an inferior good like junk food.

Section B

Q. number	Performance in General
10(a)	Satisfactory. Many candidates pointed out correctly that, although both income groups spent the same amount of money on masks, such spending would constitute a higher percentage of income to the low-income group than to the high-income group. Misunderstanding the meaning of the word 'justify' in the question, some candidates chose to present their own views in the form of normative statements, rather than providing economic reasoning to support the given statement.
10(b)(i)	Excellent.
10(b)(ii)	Good. While most candidates correctly stated that 'CU mask' is not a public good, not all of them could give a precise explanation. Quite a few candidates described the mask loosely as rivalrous (rather than rivalrous in consumption). Some confused 'rivalrous' with 'excludable'. Some answers were self-contradictory, e.g. 'the CU mask is non-rivalrous in consumption because concurrent consumption is not possible'.
10(c)	<p>Good. Many candidates were able to explain the case with a diagram. However, many of them made minor mistakes in their verbal explanations and/or diagrammatic illustrations. Common mistakes include:</p> <ul style="list-style-type: none"> • Wrongly stating that 'demand being more inelastic than supply' is the condition for the reduction in total expenditure as a result of the subsidy. • Wrongly comparing the changes of price and quantity, instead of comparing their percentage changes. • Failing to label the demand curve and/or the supply curve. • Failing to indicate that the fall in total expenditure due to the price decrease [Area (-)] and the rise in total expenditure due to the quantity increase [Area (+)], or failing to show in the diagram that Area (-) > Area (+). • Mis-reading the question and discussing the shares of subsidy benefits or changes in the consumer surplus vs. the producer surplus (which is not required by the question).
10(d)	Satisfactory. In explaining the externality involved in mask-wearing, most candidates were able to make use of keywords such as 'without compensation' or 'without receiving payments'. Some candidates confused the definition of positive externality with its corresponding inefficiency condition ' $MSC < MSB$ '. A few candidates tried to explain how subsidy could improve efficiency not from the perspective of the mask consumers (where consumption externality does prevail), but rather from that of the producers (where production externality does not exist).
11(a)	Satisfactory. Many candidates were able to show the deflationary (output) gap correctly in their diagrams, but demonstrated limited understanding of the nature of the gap in their verbal explanations. A few candidates confused the deflationary gap with deflation, while some mis-applied the concept of efficiency to their definition of the gap.
11(b)	<p>Satisfactory. Some common mistakes include failure to</p> <ul style="list-style-type: none"> • explain clearly the reasons behind the shifts in SRAS and AD. • mention the decrease in output (as a result of the curve shifts) before showing the widening of the output gap in the diagrams.
11(c)	Fair. Some candidates did not understand the meaning of open market operation and suggested other kinds of expansionary monetary policy instead. Some failed to state clearly how the drop in interest rate (due to open market purchase) would affect aggregate output via the various components of aggregate demand (e.g. investment, consumption). Lower performing candidates mistook the increase in money supply as a cash transfer and claimed that it would raise disposable income directly.

Q. number	Performance in General
12(a)	Good. Most candidates were able to identify the high cost of child-raising and gave a proper explanation on why the cost has been rising in the past three decades. Lower performing candidates simply asserted that the cost of child-rearing was high without mentioning its increasing trend.
12(b)	Fair. Some candidates overlooked the requirement of the question which required them to provide reasons for the <u>simultaneous</u> rise in population <u>and</u> decline in labour force, i.e. the opposite trend. Some answers included 'immigrants who were mostly students, housewives, and retired persons'. But while such immigrants would increase HK's population, they would not cause a drop in its labour force.
12(c)	Good. Many candidates could identify the vacancies in the elderly care service industry as shortage or excess demand for labour, and correctly included an increase in supply into their answers. Some candidates incorporated 'increase in demand' in their analysis as well, which would earn full credit as long as their answers showed an excess demand after the shift of all the curves. Some candidates who performed poorly wrongly drew a supply-demand diagram for the product (instead of labour-input) market of elderly care services. Others did not seem to realise a labour shortage would arise whenever the wage rate lies below its market-clearing level. Some simply asserted that there was an increase in labour supply without relating it to the importation of labour.
12(d)	Poor. Candidates failed to demonstrate a good understanding of Balance of Payments. Some did not seem to realise that imported workers with two-year contracts are counted as HK residents, and mistook this given case for importation of services or factor incomes paid abroad. Others confused the term 'current transfer' with 'transfer payment'. Some higher performing candidates managed to identify remittance as current transfer, but wrongly concluded that the current transfer of HK would increase (rather than decrease). Some claimed that the consumption expenditure of the imported workers should be recorded as export of services (like tourist expenditure), which is incorrect.
12(e)	<p>Generally speaking, most candidates made a good attempt to understand the issue of declining labour force and to analyse the two policy strategies. However, many of them did not evaluate the two strategies as required. Some candidates did not read the question carefully or use economic terms accurately in their discussion. A few of them failed to present their arguments in an organised manner.</p> <p>Aggregate output:</p> <p>The performance was good. Most candidates were able to identify one or more factors affecting aggregate output and to deduce their conclusions correctly. Candidates who performed well read the question carefully and analysed both the short-term and long-term effects systematically in separate paragraphs. A few candidates focused only on the effects of the strategies on aggregate demand, and did not examine the effects on aggregate supply nor address the problem of labour shortage. One common mistake made by candidates was to jump to the conclusion about the change in aggregate output without discussing possible changes in long-run aggregate supply (LRAS) and/or short-run aggregate supply (SRAS). Some candidates misinterpreted the question, discussing instead the automatic market adjustment under a deflationary gap.</p> <p>Government expenditure:</p> <p>The performance was satisfactory. Some candidates mis-read the question and provided a lengthy discussion of the effects on fiscal balance (rather than government expenditure). Others mis-interpreted the cash granted to parents as an increase in government consumption expenditure. Regarding Strategy I, lower performing candidates claimed that a bigger population in the future would bring higher tax revenue (which may be true in the long term) while lowering government expenditure (which is incorrect). Regarding Strategy II, a few candidates mis-stated that the government needed to subsidise wage payments to the imported workers.</p>

	<p>Labour productivity:</p> <p>The performance was fair. Some candidates confused labour productivity with labour supply (labour employment, to be exact), thinking that an increase in the latter would necessarily raise the former. They failed to state correctly the formula for labour productivity thus losing focus in their discussion, not knowing exactly whether the factors they considered would affect output (the numerator) or labour input (the denominator) or both. Higher performing candidates were able to make use of Source D, citing the fact that the number of imported high-skilled workers would exceed their lower-skilled counterparts, and therefore reached their conclusions correctly.</p>
12(f)	<p>Good. Many candidates managed to come up with a good alternative strategy, but not all of them could provide a proper elaboration. Some ignored the clause, 'other than those mentioned in (e)' in the question, and mis-stated the provision of subsidy to parents (i.e. Strategy I) as their answer. Others mis-asserted that the labour force could be increased via a reduction in unemployment benefits or even an imposition of a tax on the unemployed population, forgetting that, by definition, the jobless has already been included in the labour force.</p>

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.

Acknowledgements

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

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http://www.chinadaily.com.cn/business/2017-08/25/content_31084147.htm
- Sporting Intelligence Value for money by positions and age in football: That striker on big wages is probably not being paid enough
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- Census and Statistics Department Table 7 Exports and imports of goods and services (b) Year-on-year percentage change in nominal terms
<https://www.statistics.gov.hk/pub/B10300012020QQ02B0100.pdf>
- Census and Statistics Department Fertility Trend in Hong Kong, 1981 to 2017
<https://www.statistics.gov.hk/pub/B71812FA2018XXXXB0100.pdf>
- Census and Statistics Department Table 1 (cont'd) Projected labour force participation rates (excluding foreign domestic helpers) by sex and age group, 2017 to 2066
<https://www.statistics.gov.hk/pub/B71710FB2017XXXXB0100.pdf>
- Census and Statistics Department Table 1 (Cont'd) Key summary statistics
B. Components of population growth
https://www.censtatd.gov.hk/en/data/stat_report/product/B1120015/att/B1120015072017XXXXB0100.pdf
- Census and Statistics Department Economically Inactive Population by Sex, Age, Year and Economic Activity Status
<https://www.bycensus2016.gov.hk/en/bc-mt.html?search=C112>
- Legislative Council Secretariat Key Statistics - Statistical Highlights
Supplementary Labour Scheme (Paper No.: ISSH29/18-19)
<https://www.legco.gov.hk/research-publications/english/1819issh29-supplementary-labour-scheme-20190816-e.pdf>

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