

# EXAMINERS' REPORT

## AM ECONOMICS

FIRST SESSION 2018



**L-Università  
ta' Malta**

**MATSEC  
Examinations Board**

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## Statistical Information

GRADE	A	B	C	D	E	F	ABS	TOTAL
NUMBER	11	32	47	34	9	20	8	161
% OF TOTAL	6.8	19.9	29.2	21.1	5.6	12.4	5.0	100

Candidates are expected to answer 2 questions from each section. Each question carries a total of 25 marks and marks are assigned out of 50 for each section. A total of 161 candidates were registered to sit for the examination. 7 candidates reported absent from the examination. A total of 154 scripts were corrected.

### Section A

#### Question 1

- Overall, candidates showed a moderate-to-good understanding of the Production Possibility Frontier; although some failed to properly illustrate how changing production levels affects the marginal cost of producing a good.
- Overall, candidates showed a very good understanding of the supply and demand framework.
- Some candidates struggled with the application of the supply and demand framework to a real-world situation (in this case rent control).

This question was answered by 39% of the candidates and the average mark obtained was of 15/25.

#### Question 2

- Answers to this question were either very good or very poor. Those that provided poor answers showed a lack of understanding of the different ways in which different factors (i.e. prices and income) affect the budget line. Some candidates lost marks for not properly labelling the diagram needed to support the answer.
- Overall, candidates showed a good understanding of the concepts of marginal utility and equi-marginal utility.
- Overall the candidates showed a good understanding of how the individual demand curve related to the market demand curve. This was generally illustrated with the use of an appropriate diagram.

This question was answered by 40% of the candidates and the average mark obtained was of 14/25.

**Question 3**

- a) Candidates showed a very good understanding of the concepts of price- and income-elasticity of demand. These were generally discussed with the use of appropriate formulas.
- b) Overall, candidates showed a good understanding of the concept of cross-price elasticity of demand; and presented the appropriate formula.
- c) Candidates generally struggled with the application of the concepts discussed in part (a) and (b) to real-world situations.

This question was answered by 60% of the candidates and the average mark obtained was of 16/25.

**Question 4**

- a) Candidates showed moderate understanding of the concept of diminishing marginal physical product. Marks were lost either for not using the appropriate diagrams, or for not labelling the diagrams fully and correctly.
- b) Overall, candidates made good use of the appropriate cost curve diagrams to apply the concepts discussed in part (a) to the labour market.
- c) Candidates showed a good understanding of the concept of price elasticity of supply. Generally, they made use of appropriate diagrams.

This question was only answered by 7% of the candidates and the average mark obtained was of 14/25.

**Question 5**

- a) Overall, candidates showed a very good understanding of the functioning of a perfectly competitive market; and made use of appropriate examples.
- b) Overall, candidates showed a very good understanding of the functioning of a monopoly market; and made use of the appropriate diagram.
- c) A portion of candidates answering this question showed poor understanding of the characteristics of a monopolistic market. Some candidates failed to differentiate a monopoly market from a monopolistic market.

This question was only answered by 20% of the candidates and the average mark obtained was of 13/25.

**Question 6**

- a) Overall candidates showed a very good understanding of the factors that affect the demand for labour. The majority made use of appropriate diagrams; but many lose marks for inaccurate labelling/drawing.
- b) Candidates provided very poor answers. This reflects the challenge of applying microeconomic tools to real world situations.
- c) Candidates showed a good understanding of the various determinants of the wage elasticity of labour demand.

This question was only answered by 22% of the candidates and the average mark obtained was of 11/25.

## Section B

### Question 7

a) Overall the answers for this part of the question were correct with a good description of the various components which together constitute the circular flow of income. Some answers showed inaccuracies in the graphical illustrations provided.

b) The replies given for question part 'b' were generally correct and gave a good description of the various reasons why GDP is not necessarily a good measure of the standard of living. Some candidates included in the answer a description of the three methods which could be used to generate GDP. This was not requested.

c) The majority of the answers were correct and included a good number of costs and benefits which are linked to economic growth. Some of the answers failed to include an adequate number of costs/benefits or lacked the necessary explanation for the mentioned costs and benefits.

This question was answered by 69% of the candidates and the average mark obtained was of 16/25.

### Question 8

a) Most of the answers correctly explained the meaning of the slope of the consumption function and the meaning of the income multiplier in terms of the link between the two.

b) Whilst most of the replies provided a good explanation of the accelerator principle, the reasons provided for volatility of the components lacked the necessary explanation.

c) The explanation of the contractionary fiscal policy was generally correct, with most of the answers mentioning that there is excess capacity in the economy leading to demand deficient unemployment. Some of the replies lacked in the necessary requested detail and others did not include a graphical illustration which would have helped in the explanation of the link between fiscal policy and the generation of a deflationary gap.

This question was answered by 12% of the candidates and the average mark obtained was of 15/25.

### Question 9

a) The replies provided for part (a) were generally correct and a good description of each of the motives for holding money was given by most candidates.

b) The process of credit creation was well explained in most of the answers provided and most candidates correctly provided a numerical example to show the workings of the money multiplier. The implications of a decline in the reserve ratio were not well explained in some of the replies.

c) The majority of the answers provided correctly identified and explained the 'expansionary' open market operations. Whilst noting that most of the answers made good use of an appropriate diagram to explain the impact on the equilibrium interest rate, the explanation given in some cases was lacking in terms of detail.

This question was answered by 25% of the candidates and the average mark obtained was of 16/25.

**Question 10**

- a) Overall the definitions provided for inflation/deflation/hyperinflation were correct and most of the replies correctly mentioned and explained the main economic costs generally associated with persistent high rates of inflation.
- b) The difference between the two concepts was clearly explained in the answers provided. The concept of stagflation is well explained although one notes some inaccuracies in some of the replies provided.
- c) Candidates who answered this question correctly defined the Phillips curve relationship and made good use of the graph to depict the relationship between inflation and unemployment. Most of the candidates discussed the context within which this relationship is expected to hold. Some of the answers lacked the necessary level of detail.

This question was answered by 42% of the candidates and the average mark obtained was of 18/25.

**Question 11**

- a) Most of the answers provided clearly distinguished between structural and frictional unemployment. The answers given in terms of the policy to deal with the unemployment issue was also generally correct and in most cases referred to a local example.
- b) Overall, the replies to this question were correct and included a good explanation of the difference between national debt and a government budget deficit.
- c) Some of the answers to the question lacked the necessary detail in terms of the impact on the economy of the successful supply side policy. The graphical illustrations were generally correct and the other examples of supply side policy were correctly explained.

This question was answered by 24% of the candidates and the average mark obtained was of 15/25.

**Question 12**

- a) This part of the question was correctly answered by most candidates. Some of the examples used by candidates were rather complex and simpler examples could have been used. This would have helped in the explanation of the concepts of 'absolute advantage' and the 'law of the comparative advantage'.
- b) Most of the replies provided, correctly mentioned the three methods that can be implemented by government to restrict trade. The explanation as to why the authorities would want to implement such policies was not clear in some of the answers as candidates focused more on the methods.
- c) The explanation of the BOP components was generally correct. Some errors are to be noted in terms of the impact of the depreciation of the British Pound against the Euro.

This question was answered by 18% of the candidates and the average mark obtained was of 17/25.

## **PAPER II**

The second paper consisted of six questions. Questions 1 to 3 were grouped in section A and tested candidates' ability to interpret and evaluate microeconomic theory and data relating to firm behaviour; while questions 4 to 6 were grouped in section B and tested the candidates' skills at understanding and interpreting macroeconomic data and theory and their mathematical acumen on questions related to monetary economics in the context of the EMU, public finances and its relationship with economic growth and aggregate demand theory.

Candidates had to answer three out of the six questions, with at least one from each section. As was the case in previous years, the majority of the candidates preferred to answer two questions from Section A and one question from Section B.

### **Question 1**

This question tested the candidates' understanding of demand and supply theory in the case of electric cars. The candidates were asked to plot the demand and supply schedules and indicate the point of equilibrium, calculate the price elasticity of demand at two different price levels, identify four supply factors pertaining to the case at hand, discuss market changes brought about by the introduction of a government subsidy and compare and contrast the changes in consumer, producer and economic welfare between the case of introducing tax rebates to the case of handing out subsidies as different government policy measures.

The majority of candidates had no difficulty in plotting the demand and supply schedules. As was the case in previous years, a number of candidates struggled with the computation of price elasticity of demand. Furthermore, many candidates had difficulty in analysing the market effects brought about by the introduction of a government subsidy. Also, nearly all candidates failed to provide a detailed answer when asked to elicit the differences in market welfare between handing out producer subsidies as opposed to the introduction of tax rebates to consumers purchasing an electric car.

### **Question 2**

Question 2 focused on the theory of the firm through an applied example. Candidates were given the average costs and revenues associated with each level of output and were requested to compute the total cost, the marginal cost, the total revenue and the marginal revenue at each level of output and to plot the marginal and the average cost and revenue curves. Subsequently, candidates were requested to identify the profit- and the revenue-maximising level of output, discuss the theoretical relationship between the average and the marginal revenue curves and to identify changes in the cost and revenue structures of the firm from: i) an investment in new technology which increases productivity and, ii) an increase in the price of one of the factors of production.

The majority of candidates lacked the ability to explain the relationship between the average and the marginal revenue curves. Furthermore, most candidates faced difficulties in highlighting the changes brought about by an increase in the price of one of the factors of production and the change from new technological investment which increases productivity.

### **Question 3**

Questions 3 tackled the demand for and supply of labour services in determining the optimal wage rate in a start-up firm setting. Candidates were asked to calculate the marginal cost of labour, the total cost of labour per day, the total revenue from product sales and the marginal revenue based on the data presented. Utilizing this information, candidates were subsequently asked to find the optimal number of workers to achieve profit-maximising, calculate the total hourly wage bill, hourly revenue and the profit per unit at the profit-maximising level of output.

#### **Question 4**

Question 4 tested the candidates' understanding of labour market theory through questions based on a synopsis from a number of data releases including the Labour Force Survey, the Gainfully Occupied Population and the Registered Unemployed statistics. Candidates were asked to highlight the salient differences between data based on the Labour Force Survey from that based on Gainfully Occupied. Candidates were expected to discuss at length the role of Jobsplus as the main employment agency of Malta, outline the reasons as to why unemployed persons should register with Jobsplus, demonstrate the understanding of labour supply through a case scenario, discuss the possibility of zero unemployment and outline the most important factor which helped Malta to maintain wage moderation in recent years.

Candidates correctly identified the role of Jobsplus in the economy and most answers correctly identified an increase in labour supply as a possible explanation for subdued wage increases in Malta. However, a number of candidates could not identify the differences between Jobsplus' Gainfully Occupied Population and the NSO's Labour Force Survey. A large number of candidates incorrectly defined labour supply and unemployment. In the former case, this led to incorrect answers to the third part of the question with most candidates stating that a decrease in unemployment increased labour supply. A significant number of candidates attributed the unfeasibility of a non-zero unemployment rate to incorrect factors, such as persons with disability and people who choose not to work, thus showing a lack of understanding of what unemployment is.

#### **Question 5**

Question 5 presents a summary of the main macroeconomic forecasts indicators presented by the Ministry for Finance in the Draft Budgetary Plan for 2018 and asks questions related to the Government's objectives to conduct macroeconomic forecasting. Candidates were asked to discuss factors attributed to the external side of the economy, to outline the relationship between wage and productivity developments, and discuss inflation differentials at EU level. Candidates were required to outline whether there are any fiscal rules that the Maltese Government must follow giving its attainment of fiscal surplus. Furthermore, candidates were asked to discuss the potential economic effects which could emanate from BREXIT.

Most candidates performed well in the parts asking for the reasons behind economic forecasts, the external side of the economy and the potential effects of Brexit. However candidates' performance was overall quite poor in the rest of the questions. Fewer than expected candidates correctly linked wages and productivity developments. Moreover, a very large number of candidates could not explain why government finances need to be monitored even though Malta is registering fiscal surpluses. In this question candidates often cited the Maastricht criteria which are not related to the Stability and Growth Pact which governs medium-term structural objectives. In the question on inflation differentials most candidates failed to mention imported inflation and again tried to explain this concept using the Maastricht criteria showing a lack of understanding of inflation dynamics and of the Maastricht criteria.

**Question 6**

Question 6 relates to aggregate demand theory, specifically requesting students to demonstrate mathematical capabilities to identify the equilibrium level of income, identify the value of the income multiplier and identify the savings function subject to income and consumption data.

Most candidates performed well in this question. Mathematical answers were generally well explained. In some cases candidates showed some confusion on the definition of the income multiplier.

Chairperson  
Examiners' Panel 2018