

UNIVERSITY OF MALTA

SECONDARY EDUCATION CERTIFICATE

SEC

ECONOMICS

MAY 2015

EXAMINERS' REPORT

**SEC Economics
May 2015 Session
Examiners' Report**

Part 1: Statistical Information

Table 1 shows the distribution of grades for the May 2015 session of the examination.

GRADE	1	2	3	4	5	6	7	U	ABS	TOTAL
PAPER A	12	30	36	63	42	-	-	24	3	210
PAPER B	-	-	-	6	14	9	13	17	9	68
TOTAL	12	30	36	69	56	9	13	41	12	278
% OF TOTAL	4.3	10.8	12.9	24.8	20.1	3.2	4.7	14.7	4.3	100.0

Part 2: Comments regarding candidate's performance**GENERAL REMARKS**

It must be said that this year's candidates provided some excellent answers and there was generally a very high level, especially in the answers of paper 'A' candidates. A good number of candidates were able to demonstrate a good understanding of the basic economic concepts and substantiate these with international and national current examples. Excellent answers were also supported with correct economic terms and supported their answers with diagrams.

Yet, as has been seen in previous years, a number of candidates were unable to understand the requirements of the questions and gave 'off the cuff' answers, without any reference to economic terms. Clear diagrams and sketches also need to be clearly and properly labelled, a fact that is often missing. Candidates are advised to refer to the number of marks being allocated, as this is an indication of the level of detail required in the question.

Paper 1

The paper was made up of two sections, Section A – Micro Economics, and Section B – Macro Economics. Each section comprised three questions and candidates were expected to answer four questions.

Section A – Micro Economics**Question 1**

This question dealt with market forces.

- a. Most candidates correctly defined the term 'market price' and successfully illustrated, by means of a diagram, how a market equilibrium is established through the interactive forces of demand and supply.
- b. It is to be noted that when listing the determinants of demand and supply of crude oil, a significant number of candidates failed to consider that the factors that determine consumers' and suppliers' behaviour as separate and distinct from one another. For example, very common errors were statements such as '*the supply of oil is determined by consumer demand*' or that '*the demand for oil is determined by supply*'. Suppliers of any

good or service do not react directly to changes in demand, but to changes in price. An increase or fall in demand brought about by, for example a change in income or by an aggressive marketing campaign, would lead to a change in price. It is this change in price that would induce suppliers to change their output levels. The same reasoning applies to consumer behaviour in the face of changes in supply brought about by such determinants as changes in weather conditions in the case of food or the development of new sources of energy in the case of crude oil.

- c. Most candidates satisfactorily answered this question, but a significant number of responses seem to indicate that both the passage and the questions set were not read carefully by some candidates. The point behind question (c) was to elicit, in conjunction with the diagram used in answering question (a), a graphical illustration of an inward shift in demand and an outward shift in supply and for candidates to use these in order to illustrate lower oil prices. Apart from the fact that the verbal explanation written by some candidates did not reflect the information illustrated by the diagram, a significant number of candidates drew separate diagrams to represent demand and supply, when the passage set clearly indicated that the lower prices of crude oil in 2014-2015 was brought about *both* by lower demand and higher supply.
- d. Most candidates satisfactorily defined a cartel as an organisation of suppliers that attempts to control market prices through collusion, usually by limiting output through the setting up of output quotas for its members. OPEC is a perfect example of such an organisation. Most candidates correctly pointed out that through its market dominance, a cartel would behave as a monopolist would, limiting supply and earning abnormal profits at the expense of consumers.
- e. This question proved to be a mark-earner for those candidates who take a close interest in reading about and following current affairs. Indeed, a good number of candidates correctly pointed out that OPEC's failure to intervene in their November 2014 meeting in Vienna in order to stabilise an over-supplied oil market was due to their failure to agree on output quotas. This failure to collude was brought about both by political squabbles amongst members and the fiscal deficits of some governments in the oil producing and exporting countries of the Middle East, Africa and Central America. Another factor was the desire of OPEC countries to 'flood' the market with cheaper crude oil in order to exert pressure on countries such as the USA to reduce their investment in new sources of energy such as shale oil.

Question 2

This question covered elasticities and was the least popular question answered by the candidates. However, those who answered it fared better in this question when compared to their performance in the other questions.

- a. Most candidates received high marks for this question although a significant number of candidates made use of incorrect or incomplete formulas when working out the coefficients of price, income and cross elasticity of demand for wine.
- b. Responses to the question were also generally good, with most candidates noting that the demand for wine is to be considered as price inelastic due to addiction and cultural influences, The demand for wine is however income elastic, particularly good quality wine, as this is considered as a superior good, with demand increasing as income increases. Most candidates also noted that wine and beer should be considered as substitute goods and not, as suggested by the question set, as compliments. Hence, if the price of beer increases by 5%, the demand for wine should increase by 0.25% and not fall by 0.25%. In other words, the relationship between a change in the price of beer and the demand for wine should be considered as positive rather than negative. Indeed, it is not common practice for people to consume beer and wine together, even though this may be true for wine and soft-drinks.

- c. While most candidates correctly focused on the determinants of price, income and cross elasticities, a significant number of candidates failed to note that the question set specifically referred to the factors that determine the magnitude or size of **elasticity**. Such candidates answered the question by merely listing the factors that determine demand in general.
- d. Once again most candidates successfully answered this question by defining price elasticity of supply correctly and also explaining why agricultural goods, including wine, tend to respond poorly to price changes. The immobility of agricultural inputs, particularly land and labour, as well as the time factor involved in the growing and harvesting of grapes were the most listed factors. Unfortunately however, as in the case of the answer to question 1(b), a significant number of candidates mixed up supply with demand and even suggested that the inelastic demand for food, it being a basic necessity, was the main determinant for the inelastic supply of wine.
- e. This question too was in most cases successfully answered, with candidates drawing up diagrams illustrating an outward shift in the demand for wine and a resulting increase in price. However a number of candidates produced incomplete diagrams. For example, some candidates failed to include a supply curve for wine. Hence it was not possible for them to show the resulting increase in price. Others left out the necessary labels specifying which were the demand and supply curves or which axis represented the price and quantity variables.

Question 3

This question covered demand and supply for labour, and was a very popular choice.

- a. In general most candidates satisfactorily defined the Maltese '*labour force*' as: *all persons who are able and willing to actively participate in the labour market and are above the age of 15*. As indicated by the NSO data provided, the labour force includes all those in full-time employment, part-time employment (including those with reduced hours) and the unemployed. In other words, the labour force represents Malta's labour supply. The positive changes in social perceptions towards education and female work participation, along with social assistance and improvements in working conditions were the main factors cited that contribute towards the current changes being observed in Malta's working population size.
- b. Most candidates, mainly those who carefully observed the data provided, successfully answered this question by stating that measuring and comparing data on a quarterly basis helps observers to determine the influence of seasonality and other short term determinants in labour employment. Some even used the tourism sector as a good example of seasonal employment, given that labour demand in this important sector of the economy is mainly concentrated in the spring and summer months.
- c. State assistance in the form of child care centres, tax allowances, better working conditions, including the introduction of flexible hours, along with better education and changes in social attitudes and perceptions were the main factors listed as contributing towards a higher female participation rate in Malta.
- d. This question too was also generally well answered, with some candidates even using the concepts of the *income* and *substitution effects* in order to explain why the relationship between labour supply and wages, while being normally positive, becomes negative as incomes reach relatively high levels. However, it sufficed for most candidates to answer the question by using the concept of opportunity cost. Workers' opportunity costs, in terms of leisure, increase as the labour supply increases and this, in spite of higher incomes, lowers the labour supply. Hence the backward bending labour supply curve.

- e. This question too was generally well answered, with candidates illustrating with the use of a diagram, how the labour market works. Given that labour demand by firms is *derived* from the value of what workers produce and given that this value falls as more labour is employed, employers would only employ more labour if wages fall. Hence labour demand is negatively sloped. Through the use of the same diagram, most candidates then explained how equilibrium wages or salaries are established by the inter-relationship between the demand for labour and the supply of labour.

Section B – Macro Economics

Question 4

This question dealt with economic development and was generally well answered.

- a. Most candidates were able to give correct indications of the two countries' economic development.
- b. Most of the candidates were able to determine that Germany had experienced economic growth and to correctly identify the reasons thereof.
- c. This question was generally well answered with correct characteristics being noted by the majority of the candidates. While most answers focused on the high birth rate, population and poverty in developing countries, some candidates opted to discuss the levels of industrialisation and capital as well as and the predominance of agriculture in these countries.
- d. Social costs were predominantly present in many answers, with most candidates were able to elaborate on the different problems associated with economic growth. A number of excellent answers also included the concept of opportunity cost and the depletion of non-replaceable resources.
- e. This question was also generally well answers with many candidates including the possibility of financial and technological aid, as well as investment infrastructure and transport networks as possible measures that can be introduced to improve economic development.

Question 5

This question covered international trade, particularly absolute and comparative advantage. This was the most popular question in this paper, and generally well answered.

- a. Most candidates adequately distinguished between 'absolute' and 'comparative' advantage.
- b. While the majority of candidates were able to identify that the United States had an absolute advantage, few candidates correctly elaborated on the reason for this. Candidates were expected to refer to the production per unit of labour in order to establish which country had an absolute advantage.
- c. This question tested the application of the opportunity cost principle to determine which country had a comparative advantage. Simply stating which country enjoyed the comparative advantage was not sufficient, as candidates were expected to show how this was determined. This was missing from quite a number of answers.

- d. As in the previous question, workings for this sub-question were essential to substantiate the answer. Unfortunately this was not always present. It is important that all workings should be neatly presented, even if not specifically asked for in the question.
- e. This was quite a general question which presented a number of good answers.

Question 6

This question dealt with government expenditure and the budget deficit.

- a. Most answers to this question were adequately tackled. However, a number of candidates confused the budget deficit with the negative balance on the current account in the balance of payments.
- b. Most candidates were well aware of the fact that a budget deficit is financed by borrowing which increases the national debt.
- c. In most cases it was correctly noted that by decreasing government expenditure, it would increase the incentive for those on decreased benefits to join the labour force. Some excellent answers discussed the effect that a decrease in government expenditure would reduce demand, which would decrease inflation.
- d. This was generally well answered with most candidates able to explain how decreasing the budget deficit by decreasing government expenditure could cause a decrease in aggregate demand and may lead to demand deficient unemployment.
- e. This was adequately answered, although many candidates tended to focus on fiscal policy measures. Candidates could have also discussed supply-side measures as an alternative way to reduce a budget deficit.

Paper 2A

Paper 2A consists of eight questions spread over two sections. Questions in Section A relate to the microeconomic field, while questions in Section B relate to macroeconomics. Candidates had to choose four questions from the eight available, with at least one question from each section. Most candidates chose two questions from each section.

Section A – Micro Economics

Question 1

This dealt with competition and market structures.

- a. The difficulty faced by many of the candidates choosing to answer this question was their assumption that *price competition* and *perfect competition* are one and the same thing, with some candidates even stating that: "*price competition is also known as perfect competition*". This is not the case. While *perfect competition* is a theoretical model that attempts to explain how efficiency in the allocation of scarce resources could be maximized, had such a market existed; *price competition* is merely one way of how firms in different types of markets attempt to compete. *Non-price competition*, such as the use of advertising, branding or product differentiation is another.
- b. Again, most candidates based their answer on the benefits that may be attained by consumers in a *perfectly competitive* market, citing consumer sovereignty, lower prices and

more choice as being the main benefits. However, even in the absence of perfect mobility, perfect knowledge and free entry and exit, both price and non-price competitive marketing techniques such as advertising, branding and after-sales services, along with other techniques may be used.

- c. This question was generally well answered, with candidate citing predatory pricing, exclusive dealing, supply restrictions, brand proliferation, aggressive advertising and pre-emptive expansion as the main weapons used by established firms against the entry of new firm.
- d. This question too was generally well answered with candidates citing government intervention and regulations as the main method used for protecting consumers from monopolistic abuse. Full marks were given to candidates that produced answers that reflect the current local situation rather than mere text book examples or outdated policies. In recent years Malta has updated its legislation by enacting or amending such laws as the Companies Act, the Competition Act, the Trade Descriptions Act and the Malta Competition and Consumer Affairs Authority Act, while policies such as nationalisation, a policy often cited by several candidates, is no longer in use.

Question 2

This discussed size of firms.

- a. Most candidates correctly defined SMEs as small and medium sized enterprises. Explaining the importance of SMEs proved to be a little more difficult with the benefits of sole ownership being cited as the most significant factor underlining the importance of SMEs. A few candidates focused on innovation, good business/client relationships and the creation of employment, as other important factors.
- b. This question that dealt with the theoretical aspects of *internal economies of scale* was generally well answered.
- c. This question too was generally well answered, although closer reference to the Maltese situation would have been appreciated.
- d. While most candidates had a good idea of Malta Enterprise's role in helping SMEs, a significant number of answers were centred only on government subsidies and on the incubation centre. Few candidates focused on the important role that Malta Enterprise has in giving advice to small entrepreneurs venturing for the first time in a new business. Malta Enterprise helps them to draw up a business plan, set up their business in accordance to Maltese company legislation, and even helps them to exhibit their products in international trade fairs in order to encourage more exports.

Question 3

Different types of costs were discussed in this question.

- a. While most candidates defined and explained the concept of Average Costs well, a significant number found problems with defining and explaining the very important concept of Marginal Costs, with some even defining and explaining only the related concept of Marginal Product.
- b. This question was generally well answered with some candidates stating that average costs fall only as long as *increasing returns* are being experienced and *marginal costs* are falling. As *decreasing returns* set in and *marginal costs* rise, average costs rise too. Hence, average cost curves are usually U-shaped and do not fall continuously as output increases.
- c. This question was generally well answered too, except for the fact that when drawing up the answer to question c(ii), only a few candidates realised that as the average cost on the first unit of

output amounted to €6 and the change in total costs from no output at all to the first unit produced, amounted to a MC of €1. This means that total costs on an output of 0 must have been €5. This also means that the firm must be incurring a fixed cost of €5 when producing no output at all. Most candidates gave a nil answer in relation to the total cost of a 0 output. However, the rest of the answer was in the majority of cases answered correctly.

- d. Defining the concept of opportunity cost was also generally correct, although such example as the alternative income foregone by an entrepreneur or an alternative investment foregone would have been more directly related to the question set than stereotyped text book examples such as forgoing the building of a school in order to build a new road.

Question 4

This question tackled externalities and market failure.

- a. In spite of the importance of current issues related to environmental problems, sustainable development and market failure, particularly in the local context, question 4 turned out to be one of the least popular. It was also a question for which candidates were ill-prepared. This is reflected in the fact that few candidates were able to successfully distinguish between the terms *social costs* and *market failure*. Indeed, a significant number of candidates merely related *social costs* to the costs incurred by the State when providing social welfare, while *market failure* was simply associated with a situation where firms go bankrupt or an economy goes into recession.
- b. Candidates who successfully answered question 4(a) also answered this question correctly, citing environmental degradation, the abusive behaviour of monopolistic firms, social and economic disparity, high unemployment and the need for governments to provide *merit* and *public* goods as examples of market failure. Lack of knowledge, resources immobility, mal-distribution of income or too much government intervention - or the lack of it - as reasons why market failure comes about.
- c. Few were the candidates who answered this question in terms of the *positive externalities* that the natural environment provides. Reflecting the general social attitude in Malta that the natural environment is an economic asset that is meant to be financially exploited to the full, the majority of candidates answering this question saw the economic aspect of natural resources only in terms of the extractive and construction industry. Predominant examples were related to quarrying, the building of factories, hotels and residential housing, and the jobs created as a result. A few candidates did however expand further and explained that a healthy natural environment is also an economic asset because it helps to improve the quality of life by reducing stress and maximising socio-economic welfare. Some also reflected on the negative effects that a degraded, polluted and congested urban environment would have on tourism and on the population in general.
- d. The most commonly suggested methods to be used in order to enhance citizens' awareness to protect the environment focused on State regulations and penalties as well as advertising campaigns. The importance of education, both at home and at school as well as through the use of the media was also cited.

Section B – Macro Economics

Question 5

This tested the candidates on their level of knowledge relating to national income and the standard of living.

- a. Candidates were expected to refer to the factors that bring about a change in national income. Many correctly referred to the fact that this occurs due to an excess of injections over leakages, or vice versa. However, a number of candidates did not

understand where the question was leading to, and mentioned factors such as 'war' and 'national disasters'.

- b. Yet again some candidates opted to answer in general terms, without any reference to macro-economic principles. The best answers discussed economic growth and standard of living. Excellent answers discussed how changes in national income affected aggregate demand.
- c. This was generally well answered, with many discussing the externalities that are associated with progress. Others cited opportunity cost of increases in production such as stress and leisure.
- d. This was quite a general question, and many candidates fared well in this part. Good answers included better infrastructure, efficient transport systems, investment in technology and investment in education.

Question 6

This question was designed to test the candidate's knowledge on the balance of payments. This was not a popular question but those who chose to answer it fared reasonably well.

- a. Most candidates gave a correct definition of a balance of payments.
- b. Most candidates correctly answered this question, with most of them also noting the net errors and omissions section in the balance of payments.
- c. A number of candidates confused the trade deficit on the balance of payments with the budget deficit. Excellent answers showed how a rising trade deficit meant an increase in imports, and how the increase in the demand for imports makes them more expensive in terms of exports.
- d. Exchange rates and the effect on the balance of payments is a weak area which highlights the need for educators to cover in greater depth. Few students were able to explain how a depreciation of the Euro would affect the balance of payments. Candidates who fared well in this section explained how a fall in the value of the Euro would make imports more expensive and exports cheaper.

Question 7

This was the most common question among candidates and the one where candidates gained the most marks on average.

- a. A correct distinction between money and the barter system was given by the majority of the candidates. Some candidates referred to money as being notes and coins, without any reference to it being a medium of exchange.
- b. The majority of candidates answered this section well, with many going into the merits of money over the barter system, referring to the qualities of money such as acceptability, portability, divisibility and durability.
- c. This part of the question tied money with inflation. Excellent answers cited how with a rise in inflation, consumers are able to buy fewer goods or services.
- d. Most candidates were able to give correct factors that affect the amount of money saved and borrowed in the Maltese economy. Excellent answers included the rate of interest, rate of taxation and prices of goods and services, among others

Question 8

This discussed issues relating to macro-economic objectives. Close to half of the candidates attempted this question. Generally, it was well answered.

- a. Candidates were asked to describe three economic objectives. Good answers described controlling inflation and unemployment as well as reducing the budget deficit.
- b. Candidates fared particularly well, explaining clearly the link between a fall in interest rates and the effect on the economy. Excellent answers cited how consumers and firms could get more loans as well as an increase in demand for goods and services among others.
- c. Candidates seem to be more familiar with demand side policies than supply side policies, demonstrating a general weakness in the area. Candidates were expected to show how supply-side factors, such as education and training as well as incentives to invest in research and development, could improve labour productivity.
- d. Most candidates were able to show how an ageing population affected Malta's economic development, correctly stating how spending on pensions incurs an opportunity cost which could impact other factors such as education. A number focused on the fact that an ageing population puts a strain on government resources in view of the rising amount of pensions that needed to be paid but did not link this with the effect on economic development.

Paper 2B

Paper 2B consisted of eight questions spread over two sections. Questions in Section A related to the microeconomic field, while questions in Section B related to macroeconomics. Candidates had to choose four questions from the eight available, with at least one question from each section. As in previous editions of the paper, candidates generally preferred to opt for three questions from the first section.

Section A – Micro Economics

Question 1

This dealt with competition and market structures and was the most popular question chosen by the candidates.

- a. In general most candidates were able to define the term 'market competition'. However, a number did not make any reference to why firms compete, with some simply stating that it refers to '*that between firms and producers on products and services*'. Candidates generally answered the second part of this question well, referring to the different methods by which firms compete, such as price and non-price competing factors for example better quality goods.
- b. Most candidates were able to give correct benefits of competition.
- c. Although this question was generally well answered, there were some misconceptions such as '*the government is the price-maker, or that the market is very small*'. These are not correct.
- d. The majority of the candidates answered this sub-question well.

Question 2

This question covered specialisation, division of labour and size of firms. Over half the candidates chose to answer this question, and those who did, fared generally well.

- a. This required a simple definition of the term 'self-sufficiency'. While the majority could state this, there were a number of inaccuracies. Some candidates chose to focus on the benefits of

being self-sufficient rather than explaining the actual term. Others referred to the rate of output. The second part of the question was relatively well answered.

- b. Most candidates were able to give benefits and disadvantages of division of labour.
- c. There seems to be a general weakness in this area. Very few candidates were able to define SMEs (small and medium-sized enterprises) and furthermore, to state the reasons why some prefer to stay small. One excellent answer explained that '*these firms prefer to remain small because they are easier to run, and since owners are completely liable they would not want to risk expanding their business in case of bankruptcy*'.
- d. This question was generally well answered, and candidates gave correct ways of how *Malta Enterprise* helps SMEs.

Question 3

Different types of costs were discussed in this question. Over half the candidates chose to answer this question.

- a. While most candidates defined and explained Total Costs and Average Costs well, a significant number found problems with defining and explaining the very important concept of Marginal Costs.
- b. A correct distinction between fixed and variable costs was made by the majority of the candidates. However, on various occasions, insurance and salaries were incorrectly deemed to be variable costs.
- c. While many candidates could state the difference between *short run* and *long run* production, few candidates could define the Law of Diminishing Returns correctly. Various candidates related this to the price and demand rather than marginal production.
- d. In general, this was poorly explained by various candidates, demonstrating a weak understanding of the benefits of lower average costs.

Question 4

This question covered externalities and market failure. This was the least popular question among candidates, and in general, those who answered it gave a poor understanding of this topic.

- a. While few could give a correct definition for the term *externalities*, a number of candidates gave correct examples of private costs and social costs.
- b. Those candidates who answered part 'a' correctly were able to give a good account of how externalities can be considered as beneficial.
- c. Very few candidates were able to explain how *market failure* may come about.
- d. The answers to part 'd' were particularly lacking in detail and in several instances candidates displayed a lack of understanding of social costs in general.

Question 5

This dealt with national income and the circular flow. Less than 40% of the candidates answered this question, and those who did, did not perform too well.

- a. Many candidates were unable to draw a correct diagram to describe the circular flow of income. Quite a number did not label the diagram correctly.

- b. While a number of candidates correctly defined leakages and injections, some referred solely to money flowing into the country by means of exports and flowing out by means of imports.
- c. This part of the question tested the candidates' application of their knowledge of injections and leakages. Most candidates answered this correctly.
- d. Few candidates were able to answer this part of the question correctly. Candidates were asked to state how injections and leakages affected the circular flow of income. A number simply stated how these would affect personal income, the firm or the government, without any specific reference to the effect on the circular flow of income.

Question 6

This question covered the Balance of Payments and international trade. Just over 20% answered this question. Performance was average.

- a. This part of the question was generally well answered.
- b. A general lack of knowledge was demonstrated by the majority of the candidates. Few could correctly distinguish between the current and capital account of the balance of payments.
- c. As in the paper 'A' candidates, the majority of the candidates understood trade deficit on the Balance of Payments as being the government budget deficit.
- d. Candidates were to show how different factors could correct a balance of payments trade deficit. A number of good answers included improvements in technology, devaluation, increasing interest rates to encourage foreign investment and deflation which would decrease spending on imports

Question 7

This question dealt with money and the Central Bank of Malta. Over three quarters of the candidates chose to answer this question. Those who answered it, performed reasonably well.

Most candidates gave a good definition for the term 'money'.

- a. The answer to the second part of this question was overall very satisfactory with most candidates being able to give correct functions of money.
- b. This part of the question was also well answered by most candidates, although a number of candidates confused functions with characteristics of good money.
- c. The important role of the Central Bank of Malta as being that of price stability was often neglected, with the majority of candidates focuses on the function of the Central Bank as being the bankers' bank and of being a lender of last resort.

Question 8

This question tested the candidates' knowledge on monetary policy. Close to half of the candidates chose to answer this question, where performance left much to be desired.

- a. While being able to show how a fall in the rate of interest affects savers, many candidates failed to discuss how a fall in the rate of interest might affect home buyers and firms,
- b. On average most candidates performed well in this part of the question.

- c. The theoretical understanding of supply-side policies was generally weak with few candidates being able to apply supply-side policies to reducing unemployment.
- d. Most candidates successfully answered this question giving a good description of the challenges that were posed by Malta's ageing population.

**Chairperson
Examiners' Panel 2015**