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| SUBJECT: | <b>Economics</b>            |
| DATE:    | 25 <sup>th</sup> April 2019 |
| TIME:    | 9:00 a.m. to 12:05 p.m.     |

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The question in Section A is **compulsory**. In addition, answer **TWO** questions from Section B and **TWO** questions from Section C.

Section A carries a total of 20 marks, while Section B and Section C each carry a total of 40 marks.

## **SECTION A**

**This question is compulsory and carries 20 marks.**

### **1. Germany's Economic Dilemma: To Save or to Spend**

Germany, in common with the rest of continental Europe, has been suffering from a lack of demand, caused in part by the Germans' high propensity to save. Other European members, subject to similar macroeconomic constraints, have done far better. What really sets Germany apart from its more successful European neighbours are its structural rigidities, its high wages and non-wage labour costs, and a rigid labour market. Schröder, who came to power promising economic revival, met only partial success. His economic policies could not revive consumers' confidence and left them in a state of suspended animation - to spend or to save.

*(Anand C Prasad & G Srikanth, 2004)*

- Define Marginal Propensity to Consume (MPC) and Marginal Propensity to Save (MPS). (4)
- Discuss how the 'Propensity to Save' can have an adverse or favourable impact on a country's economy. (4)
- With reference to the text define structural rigidities and explain how they can affect economic growth. (6)
- What do you understand by 'Consumer Confidence' and how is it relevant in reviving economic growth? Use diagrams to discuss the effectiveness of managing the economy by aggregate demand. (Hint: Use the Aggregate Demand and Aggregate Supply diagrams)(6)

**(Total: 20 marks)**

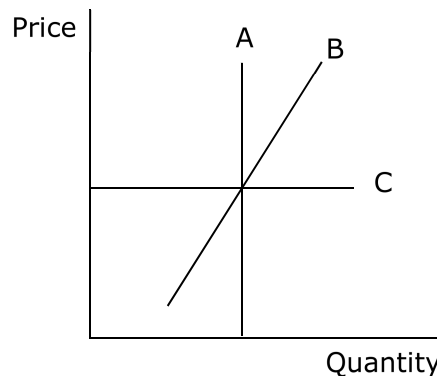
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**SECTION B**

**Answer any TWO questions in detail. Each question carries 20 marks.**

2. Olive oil is an essential ingredient to create an authentic Italian meal. The price of extra virgin olive oil increased by almost 25% in 2017 as a result of drought conditions in the Mediterranean which afflicted production of olives at major producers.

a. Define 'supply' and 'the law of supply'. (4)



b. Study the figure above. Which of the curves, A, B, or C represents the typical supply curve of olives? Briefly explain your answer. (3)

c. By means of a diagram, show and explain how the drought conditions affected the supply curve of olives. (5)

d. Define 'price elasticity of supply'. (2)

e. By means of diagrams, explain the main difference between an elastic and inelastic supply curve. (4)

f. The price elasticity of supply for olives might be inelastic. Do you agree with this statement? Briefly explain **ONE** reason why. (2)

**(Total: 20 marks)**

3. The Beach Haven is a restaurant based in Valletta. It offers "all you can eat buffet for €15.00". Consumers can refill their plate as many times as they like.

a. Define 'marginal utility'. (2)

b. With reference to the above statement, explain what is meant by 'diminishing marginal returns'. (4)

c. With reference to the above statement, using the marginal utility theory, explain how consumers determine the optimum level of consumption. (8)

d. Suppose now that on top of the €15.00 fixed charge, the restaurant starts charging €3.00 for each plate refill. Discuss why consumers are likely to consume less compared to your answer given in part 'c'. (6)

**(Total: 20 marks)**

4. Table 1 shows the distribution of the revenue received from the sale of a lemonade drink priced at €2.00 per bottle produced by a firm.

Table 1: Distribution of Revenue

| Components   | Price in Euros |
|--------------|----------------|
| Sugar        | 0.10           |
| Water        | 0.05           |
| Lemon Juice  | 0.10           |
| Packaging    | 0.05           |
| Rent         | 0.10           |
| Loan Payment | 0.05           |
| Labour       | 0.25           |
| VAT          | 0.30           |
| Profit       | 1.00           |

- a. Explain the difference between fixed costs and variable costs. From Table 1 give **ONE** example of fixed costs and **ONE** example of variable costs. (4)
- b. Explain the 'law of diminishing marginal returns'. In your answer illustrate the average total, average variable and marginal cost curves of this firm. (8)
- c. Assume that the firm experiences economies of scale up to a certain level of output, and then diseconomies of scale. Briefly discuss **TWO** factors of each and why a firm can gain from economies of scale and suffer from diseconomies of scale. (8)
- (Total: 20 marks)**
5. a. Assume that in a perfectly competitive market structure total revenue increases continuously at a constant rate. Explain profit maximisation under perfect competition. (9)
- b. Is it possible for a perfectly competitive firm to earn supernormal profits in the long-run? Explain why. (3)
- c. Argue the case for and against the following proposition. "A monopoly is always harmful". In your answer give **TWO** reasons to substantiate each argument. (8)
- (Total: 20 marks)**

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**SECTION C**

**Answer any TWO questions in detail. Each question carries 20 marks.**

6. a. Define Gross Value-Added (GVA) and using the Table below estimate the Gross Value-Added at factor cost. (8)

Table 1: Value-Added components

| Content                  | Euro million |
|--------------------------|--------------|
| Output sold (units)      | 800          |
| Price per unit of output | 20           |
| Depreciation             | 500          |
| Closing stock            | 1,000        |
| Opening stock            | 800          |
| Intermediate Cost        | 10,000       |
| Tax                      | 2000         |

- b. Why is it important to use the Value-Added when estimating the Gross Value Added (GVA) using the output approach? Explain using an example. (6)
- c. Distinguish between Gross Domestic Product (GDP) and Gross National Product (GNP). (6)
- (Total: 20 marks)**

7. a. Considering the following general form of the consumption function, explain the relationship between consumption and income. (8)

$$C = a + bY$$

- b. Derive the savings function and explain its components. (6)
- c. How is investment different from consumption? What is understood by the term Marginal Efficiency of Capital (MEC)? (6)

**(Total: 20 marks)**

8. a. What is the multiplier and how does it work? Why is the multiplier such an important principle in economics? (8)
- b. What is the relationship of the Marginal Propensity to Consume (MPC) to the multiplier process? (6)
- c. How can a change in fiscal policy have a multiplier effect on the economy? (6)

**(Total: 20 marks)**

9. a. Which account would the following transactions be entered in? (10)
- i. The sale of €2 billion worth of Maltese products to Australia.
  - ii. UK tourists spending €200 million in Malta.
  - iii. The import of €1 billion computer products from the USA.
  - iv. The purchase of shares by a Maltese citizen, worth €10 million, in a German firm.
  - v. The payment of dividends to a German citizen who owns shares in a Maltese firm.
- b. Distinguish between government deficit and a balance of payments deficit. (4)
- c. Explain **TWO** reasons why countries may engage in international trade. (6)

**(Total: 20 marks)**