Micro Common Essay Plans

Policies for Neg Ext (include common access resources/property rights)

Point 1: Tax, Eval: Regressive

Point 2: Ban, Eval: enforcement costs, overkill

Point 3: Behavioural, Eval: people don't change behaviour (demand not affected)

Point 4 (if common access resources): Pollution Permits/Property Rights, eval: international problem, easy to get around

Policies for Pos Ext

Point 1: Subsidies, Eval: dependency, opportunity cost of taxpayers' money

Point 2: Free Provision, Eval: over provision and cost

Point 3: Behavioural, Eval: no financial incentive, demand doesn't increase

Policies to reduce inequality (pre tax vs post tax)

Point 1: Progressive Taxation, Eval: Laffer Curve

Point 2: Better schooling/spending on education, Eval: opportunity cost of spending, time lag

Point 3: Minimum Wage Increase, Eval: unemployment, replacement with capital

Is inequality desirable?

Point 1: Yes, encourages people to take on education/qualifications, Eval: some people won't be able to financially afford in the first place

Point 2: No, inefficient allocation of resources and crime/poverty, Eval: crime linked to poor schooling and youth programs, not necessarily inequality

Point 3: Yes, encourages people to work harder to earn more, Eval: can be a demotivating factor too

Are monopolies (and oligopolies) good/bad?

Point 1: Bad → high prices (include collusion for oligopoly) and lost consumer surplus, Eval: depends on contestability

Point 2: Good → economies of scale, Eval: diseconomies of scale

Point 3: Good → dynamic efficiencies, Eval: SNPs may not be reinvested and given to shareholders

Is price discrimination good/bad?

Point 1: 1st degree → Good for firms because mega producer surplus, bad for consumers because no consumer surplus, Eval: some consumers can now access good when couldn't beforehand

Point 2: 2nd degree → Good for firms because more revenue, Eval: could be market seepage where people buy off peak price instead of peak product. Good for off peak consumers, Eval: bad for peak consumers as prices much higher

Point 3: 3rd degree → Good for firms because more revenue again, Eval: can upset high income consumers who choose to shop elsewhere. Bad for high demand consumers, Eval: good for low demand consumers

Are market structures efficient?

Perfect Competition: Yes → allocative efficient, productive efficient (in SR); No → dynamic efficiency, long run productive efficiency (no EofS)

Monopoly → No → allocatively inefficient if profit max (eval: contestability), productively inefficient in SR (eval: depends on business objective); Yes → economies of scale and dynamic efficiency (Eval: diseconomies of scale and not reinvesting profit)

Should the government regulate oligopolies?

Point 1: Yes, collusion is bad, need for whistleblower incentives, Eval: game theory matrix

Point 2: No, SNPs lead to dynamic efficiencies, Eval: no reinvestment

Point 3: Yes, poor service, low quantity and high prices (use max pricing), Eval: government failure

Privatisation vs Nationalisation

Point 1: Nationalised industries are inefficient, high costs and need to be subsidise by taxpayer, privatised means profit incentive lowers costs; Eval: prices might stay high with privatised industry if no competition

Point 2: Privatised means more competition, firms try to innovate and compete on price as well: Eval: nationalised monopoly could just be replaced by a private monopoly (mega bad)

Point 3: Natural Monopolies need to be Nationalised to achieve allocative efficiency and all the economies of scale; Eval: needed to be subsidised by taxpayer, regulated private firm best of both worlds

Min Wage/Trade Union Essay

See Mr Hallam's Model Answers

Negative Externality Essay Plan

Definitions:

Negative Externality of Consumption – negative effect on a third party (society) from the consumption of a good or service

Negative Externality of Production – negative effect on a third party (society) from the production of a good or service

Market Failure – misallocation of scarce resources by the free market, in the case of negative externalities there is an overallocation of resources by the free market

Examples:

Neg Ext of Con – smoking cigarettes, unhealthy food, driving cars (congestion and pollution)

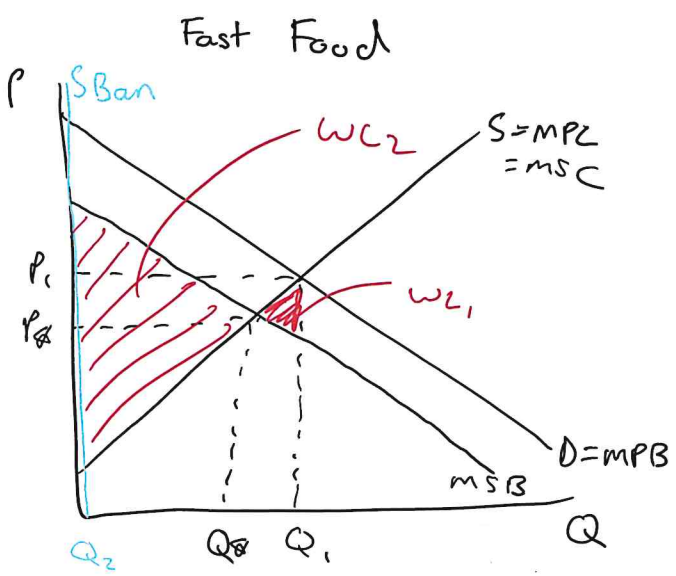
Neg Ext of Prod – non-renewable energy production, plastic production, deforestation

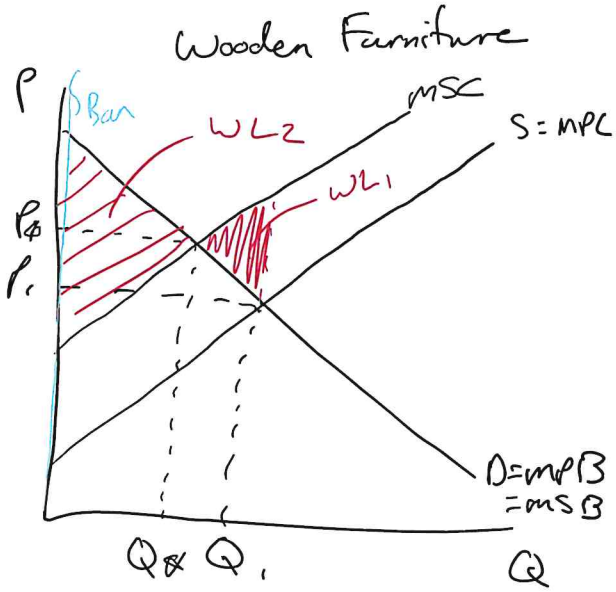
Explanation of Market Failure:

- Neg Ext of Con – the good/service is consumed at the quantity q1 where the marginal private benefit equals the marginal private cost. However, there is a negative external benefit to society from the consumption of this product. Therefore, the marginal social benefit is lower than the MPB. This creates a different equilibrium where the MSB=MSC (the social optimum) which is at q*. Because q1 is greater than q*, we have an overallocation of resources and a welfare loss of the shaded area.
- Neg Ext of Prod – the good/service is produced at the quantity q1 where the marginal private cost equals the marginal private benefit. However, there is a negative external cost to society from the production of this product. Therefore, the marginal social cost is greater than the marginal private cost. This creates a different equilibrium where the MSB=MSC (the social optimum) which is at q*. Because q1 is greater than q*, we have an overallocation of resources and a welfare loss of the shaded area.

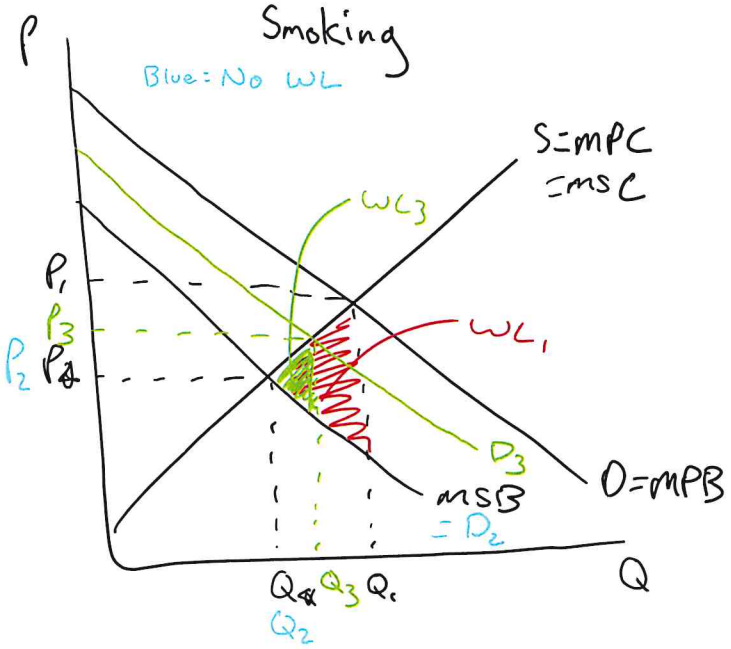
Policies to correct (including evaluation):

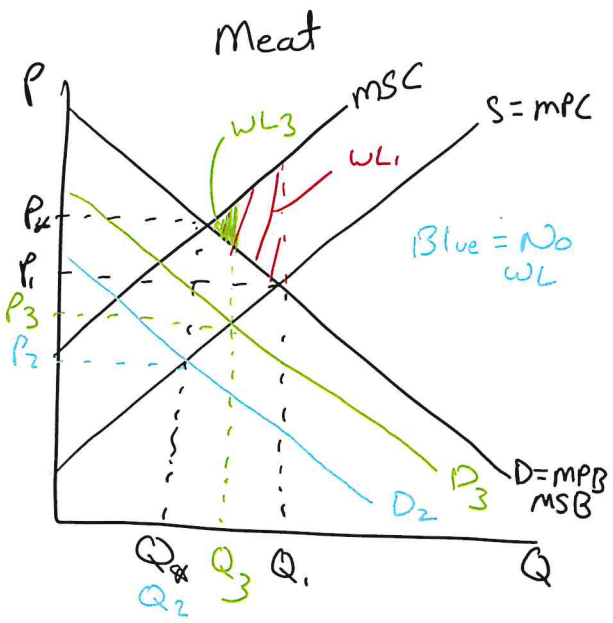
- Ban – the government can make it illegal to produce/consume any of the product. This shifts the supply curve to q=0. This eradicates the externality. An example would be automatic rifles in the UK. Eval: only effective if the negative external effect is enormous and outweighs the private benefits of consumption/production. If the marginal social benefit is still positive then this can create a much larger welfare loss. Creates black markets for the products as well.



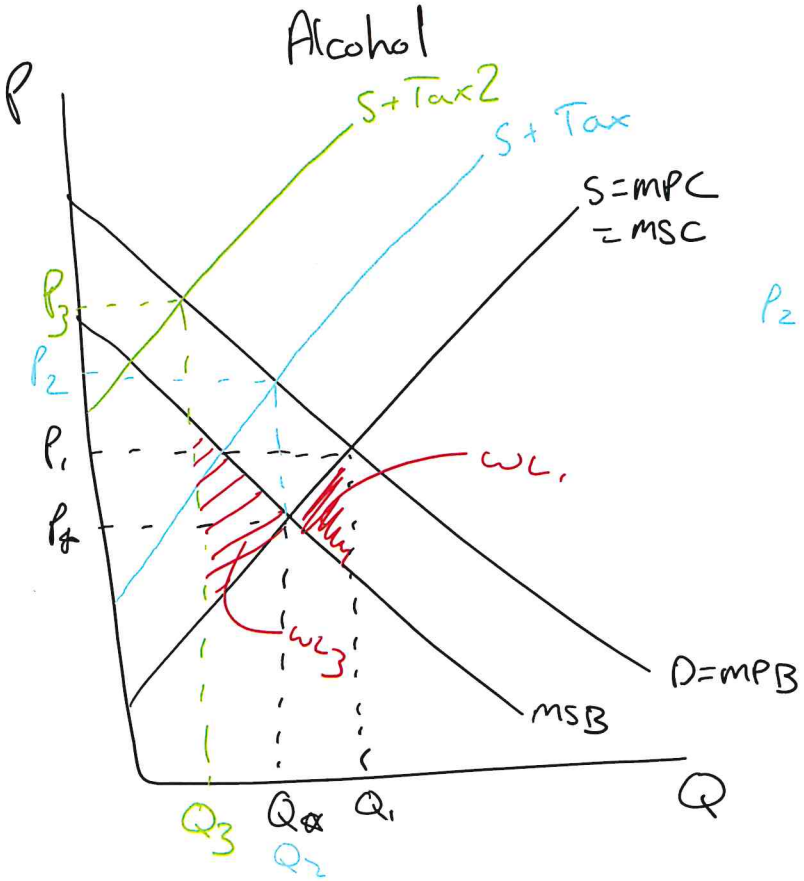


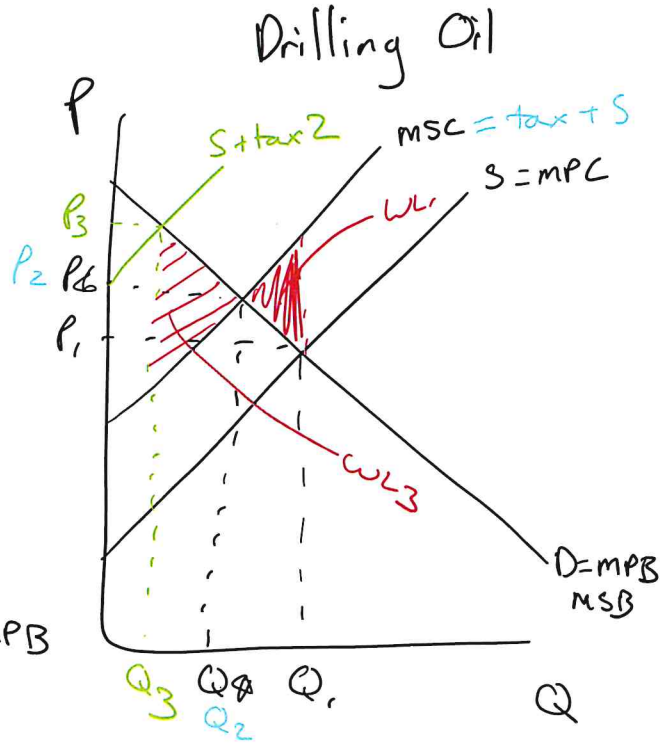
- Education/advertising – informing the consumers and producers of the full extent of the costs and benefits of the production/consumption of a good or service to influence their level of demand. This could be advertising through billboards, TV ads, school programmes etc. Smoking education in schools with data on smoking related deaths. This should shift the demand inwards towards the MSB, so that consumers internalise the externality of the market. Eval: expensive, people don't like being told what to do/don't listen, may not shift demand as far as desired



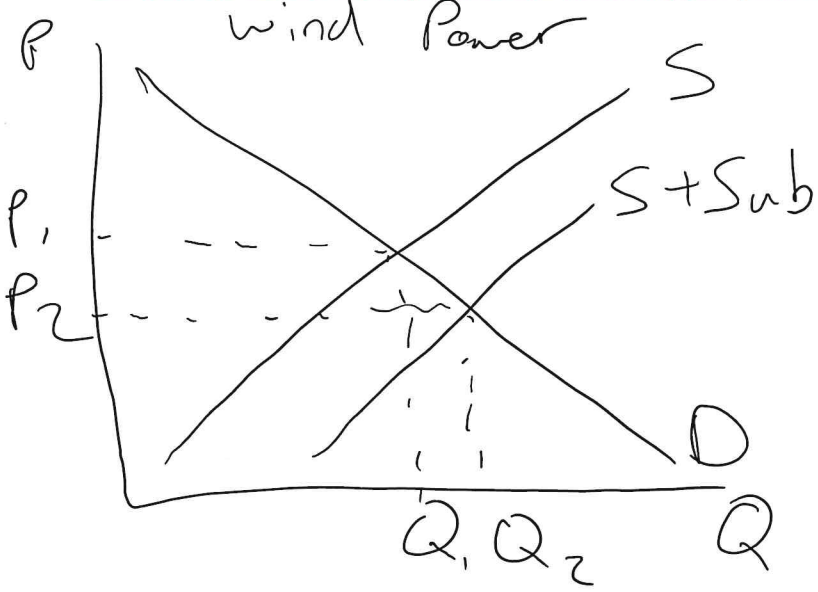


- Tax – a charge imposed by the government on the purchase of a good or service that increases the price of that product and should therefore reduce the quantity purchased. Example would be air fuel duty, sugar tax, tobacco/alcohol tax etc. The tax can be seen as a cost of production imposed on the firm selling the product. This shifts their supply curve inwards and raises the price of the good on the market reducing the quantity purchased and therefore reducing the externality. Eval: dependent on the elasticity of demand if the PED is inelastic the quantity purchased will not change significantly, taxes on products are regressive so that they increase inequality in society, overtax.





- Subsidise Alternatives – a subsidy is a government payment to a supplier to incentivise them to increase their quantity supplied by reducing their costs of production (it is an example of a supply side policy). An example might be UK subsidisation of wind power to reduce reliance on coal and gas. The subsidy will make the alternative product cheaper as the supply curve shifts out. As the product becomes cheaper, more consumers will shift their consumption away from the good with negative externalities towards the subsidised alternatives. This reduces the demand for the demerit good (a product with negative externalities) and should shift the quantity inwards to q*. Eval: will only work if the products are suitable substitutes with a strong cross elasticity of demand. Subsidies don't always lead to lower prices as the firms may just pocket the extra money from the govt.



Coal Power

Same as diagram for education with D shifting inwards

- Behavioural Economics – behavioural economics assumes consumers are irrational and act upon biases while also not fully evaluating the costs and benefits of their consumption decisions. Policies which utilise behavioural economics are called nudges. These can include choice architecture, default choices, and framing. For example: banning advertising on cigarettes and putting them behind a door will reduce the demand for the product while not influencing the price/benefit of consumption. This is an example of choice architecture where only the process of choosing cigarettes is changed and not the price. Eval: only works in cases where consumers are irrational, if consumers do actually act rationally, they will not be affected by the nudge. Lack of price incentive may limit effectiveness.
  Diagram: same as the education diagram

→ just for reg of prod.

- Pollution Permits (also known as a cap and trade scheme) – in certain areas (mainly pollution) there is a problem known as the tragedy of the commons which stems from overuse of common access resources (resources which are non-excludable but rivalrous) such as the Ozone layer or local smog. Pollution permits are given out to companies and allow them to pollute a certain restricted amount. If a firm wants to pollute over this amount they have to buy permits from other companies. The total amount of permits in the market is fixed. Companies that want to pollute more have to pay high prices for the permits which raises their costs of production and should shift their supply inwards. This creates a higher price for their products and should reduce the quantity demanded. Eval: hard to measure and set the correct amount of pollution, impossible to enforce efficiently, who sets the permit? In the EU we have a carbon trading scheme but this doesn't prevent global warming because of India, China, and the USA.

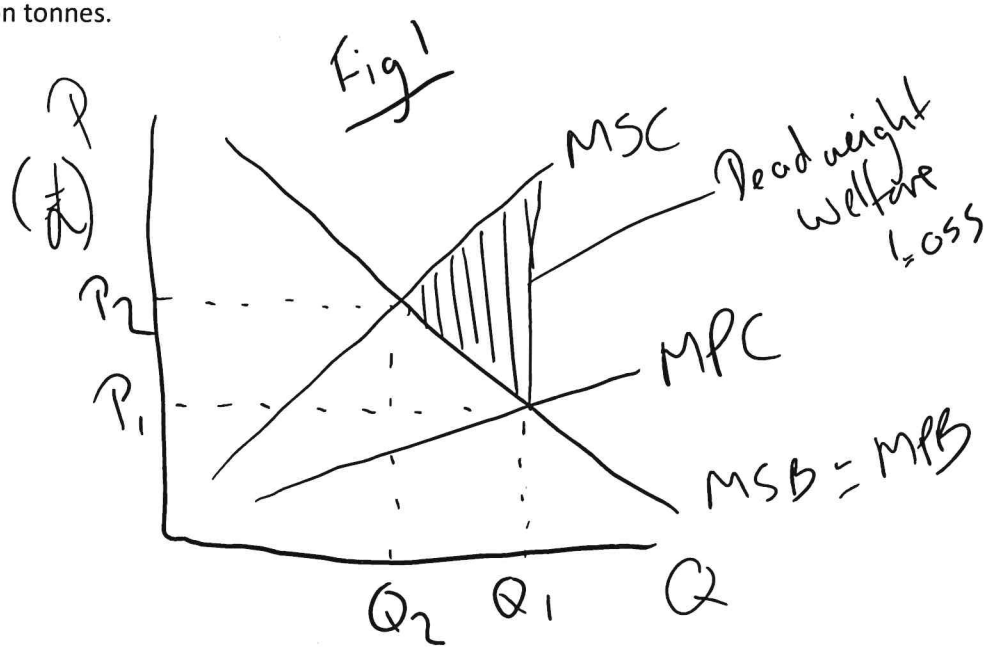
Conclusion content:

- Easy things to include:
    - Combine policies
    - Overall welfare loss to society
    - Costs to the government
    - Short Run vs Long Run effectiveness
    - Inequality and Environment
- Look at the specific question and answer it directly, for example if the question asks "are pollution permits the best way to solve climate change?" you must mention pollution permits in your conclusion and then compare it to the alternatives
- In the case of government policies, you should also look at the limitations of governments and government failure. Eg. They are self interested, inefficient, and make errors

Extract F (lines 9-10) states 'some major UK businesses appear happier with permit trading than with alternative policies such as quotas on emissions and the taxation of fuel.

Using the data in the extracts and your own economic knowledge, evaluate the possible impact on UK businesses of the policies to reduce pollution

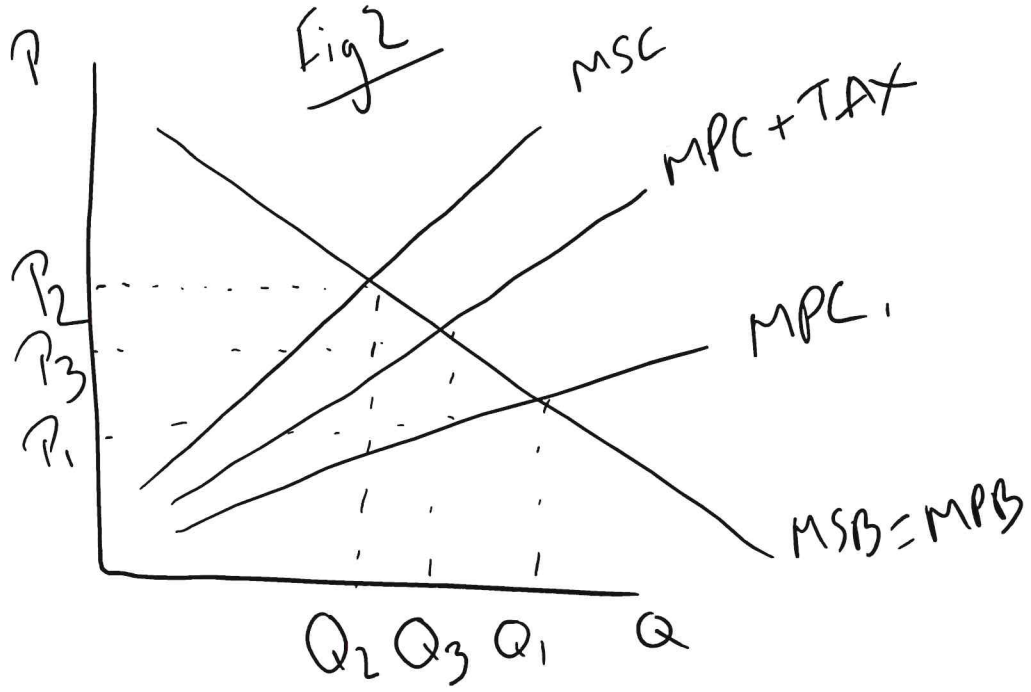
Pollution created by UK businesses when producing goods and services is a negative externality in production. A negative externality is a negative side-effect upon a third party. An example of negative externalities caused by high CO2 emissions are the economic costs created by global warming. As can be seen in fig 1 below, negative externalities in production cause the marginal social cost to be higher than the marginal private cost. The privately optimal quantity (Q1) is greater than the socially optimal quantity (Q2), as a result there is a market failure, illustrated by the deadweight welfare loss to society as resources are not been allocated at socially optimal levels. As stated in extract D, total CO2 emissions in the UK in 2010 were 500 million tonnes.



There are number of policies that could be used by the UK govt in order to reduce the amount of CO2 emissions produced by UK firms.

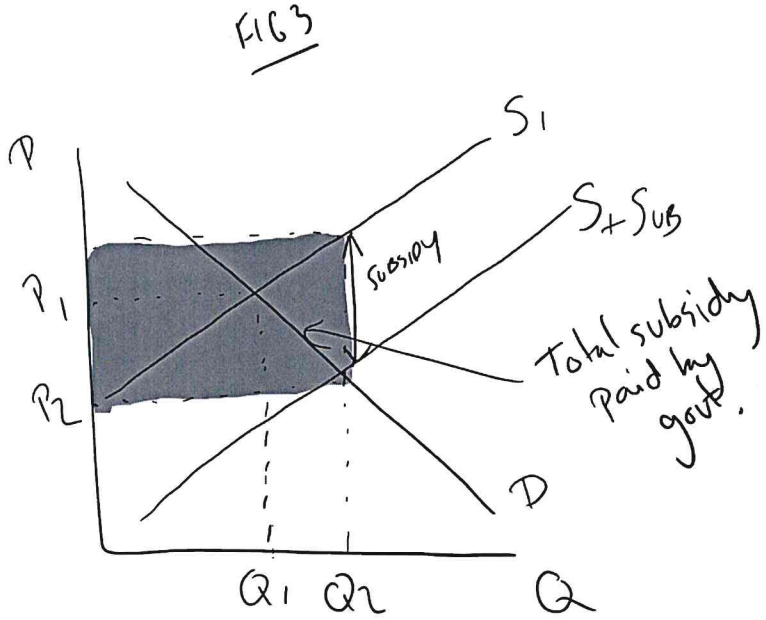
The first policy that the government could use is pollution permits such as the European Union Carbon Emission Trading Scheme. In such as scheme, the UK government sets the level of emissions that UK firms can produce and gives firms an allocation to produce a set amount of pollution. If a firm does not use its permits, then they are able to trade their permits. Permits can be an effective method for reducing pollution as the government can set the amount of pollution at Q2 which is the socially optimal level where MSC=MSB (fig1). This will impact UK firms as they may be forced to invest in new greener technology in order to produce as allocated level, this may increase costs but there is an incentive to do so as they can generate income from trading their unused permits. PED for these permits may be inelastic for firms that do not invest as there may be no short term substitute and advantage to green firms as they could sell their permits for a high price. However, there may be a number on disadvantages for UK business, as stated in extract E, the USA and China did not sign up to the Kyoto protocol which as a may mean that UK firms that invest in new technology may be uncompetitive relative to international counterparts. In extract F, it is stated that the government may over allocate to firms that they deem to be important nationally which may mean pollution permits are not equitably distributed. Also, the UK does not have a large manufacturing sector which may mean that other economies are able to pollute on the UK's behalf and global emissions are not reduced. Finally, it is difficult to calculate the size of the negative externalities and therefore it is difficult for the government to allocate permits so that CO2 emissions are reduced to socially optimal levels.

The second policy that the government could implement is a tax upon carbon fuel that creates CO2 emissions. A per-unit tax is a payment placed on firms by governments per unit of a good sold. The intentions of a tax is that it increases the MPC of UK firms; as a result quantity decreases from Q1 to Q2. The increased costs of production are passed onto the consumer in form of higher prices and lower quantity (P3,Q3). This has a number of implications on UK businesses.



Firstly, increasing costs of production could lead to a reduced abnormal profits for business which may limit the potential for these firm to invest in greener technologies reducing UK CO2 in the long run, especially if PED for the goods are elastic as an increasing costs of production are not able to passed onto the consumer. This is especially problematic given the evidence in extract F that the UK is an importer of goods and therefore is a signal that UK firms are already uncompetitive. Taxes are also regressive and this will impact smaller businesses more so than larger business who are able to absorb the cost of the tax more easily. Due to the difficulty in calculating the externality, it is also hard for the government to work out exactly the amount of tax to place on firms, this may mean that after the tax, UK firms still do not produce at socially optimal levels.

The final policy that the government could introduce is a subsidy for greener alternatives such as solar energy or offset materials such as trees that could reduce CO2 levels in the UK. A subsidy is a payment by governments to firms per quantity, this can be seen in figure 3.



A subsidy reduces the costs of production and therefore increases supply, reducing price and increasing quantity. This could be used by governments to incentivise UK firms to purchase subsidised greener material or production techniques. This may lead to lower costs and increase the competitiveness of UK firms internationally. However, there are a number of negative implications of subsidies. Firstly, increasing subsidies may lead to an over reliance on the subsidy in the long run. To be effective, the goods that are being subsidised need to have a positive and high cross-elasticity of demand in order to encourage firms to switch to greener alternatives. A subsidy is also expensive for the government and therefore could have a high opportunity cost. As stated in extract E some offset schemes have hidden environmental costs which will limit the impact of the subsidy to improve the environment. The distribution of subsidies may lead to government failure as politicians act in their own self-interest leading to a further misallocation of scarce resources.

In conclusion, each form of government intervention will have implications on UK businesses. Interventions such as subsides, may be effective in switching behaviours of firms to produce goods using green technologies and lower costs of production if XED is elastic, however, in the long-run may create a dependence upon state-aid that reduces pollution but lead to other market failure due to inefficiencies being created. Taxation of carbon fuel may reduce the incentives for firms to use such resources, however, if PED of the final product is price inelastic, then these costs can be passed onto consumers and the incentive to switch fuel supply is significantly reduced. The most effective way of reducing CO2 emissions from governments are the use of pollution permits, which although the short run consequences are quite large for UK businesses, permits strength is that they incentivise investment into green technology which is environmentally friendly as fuel efficient firms are able to sell their unused permits. However, in order to be successful, these permits need to be allocated at the socially optimal levels and enforced so that over use of the air, a common access resource, is not polluted at unsustainable levels resulting in an example of the tragedy of the commons.

Positive Externalities Essay Plan

Definitions:

Positive Externality of Consumption – positive effect on a third party (society) from the consumption of a good or service

Positive Externality of Production – positive effect on a third party (society) from the production of a good or service

Market Failure – misallocation of scarce resources by the free market, in the case of positive externalities there is an underallocation of resources by the free market

Examples:

Pos Ext of Con – healthy food, healthcare, vaping, education, public transport

Pos Ext of Prod – beekeeping, formula 1 research

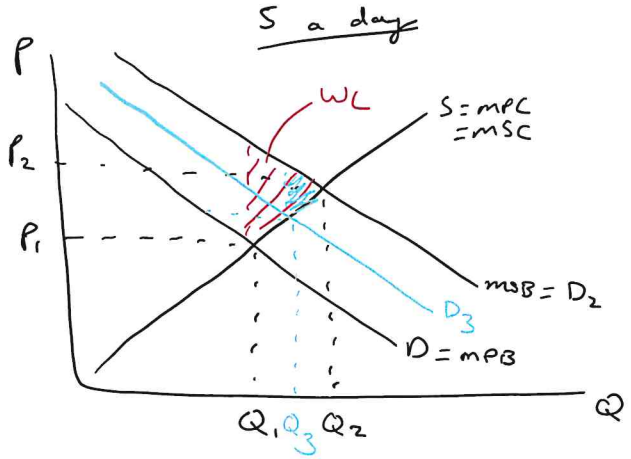
Explanation of Market Failure:

- Pos Ext of Con – the good/service is consumed at the quantity q1 where the marginal private benefit equals the marginal private cost. However, there is a positive external benefit to society from the consumption of this product which the individual and firm do not take into account. Therefore, the marginal social benefit is higher than the MPB. This creates a different equilibrium where the MSB=MSC (the social optimum) which is at q*. Because q1 is less than q*, we have an underallocation of resources and a welfare loss of the shaded area.

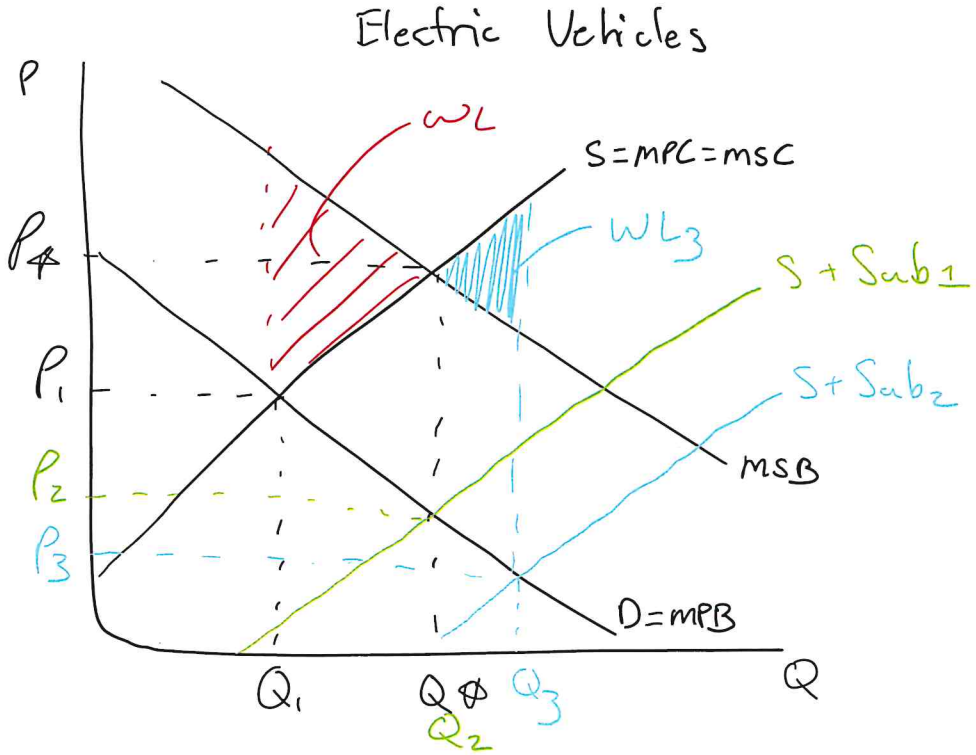
- Pos Ext of Prod – the good/service is produced at the quantity q1 where the marginal private cost equals the marginal private benefit. However, there is a positive external cost to society from the production of this product. Therefore, the marginal social cost is less than the marginal private cost. This creates a different equilibrium where the MSB=MSC (the social optimum) which is at q*. Because q1 is less than q*, we have an underallocation of resources and a welfare loss of the shaded area.

Policies to correct (including evaluation):

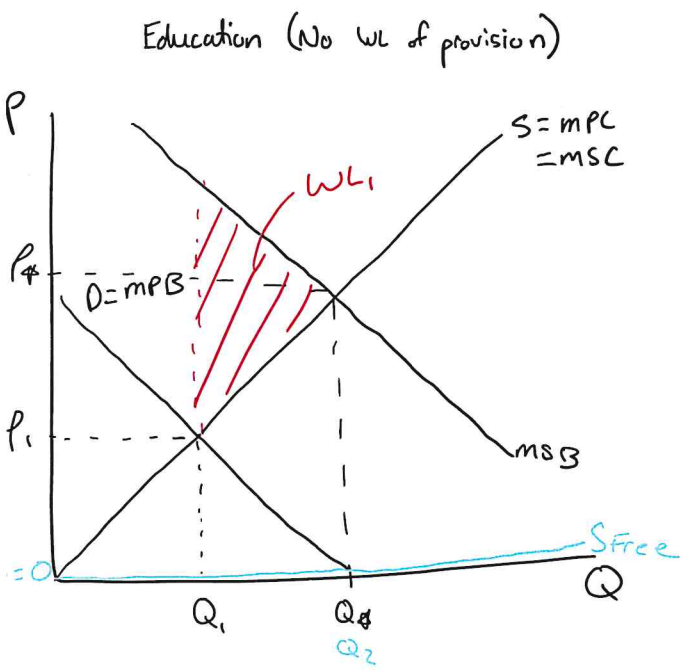
- Education/advertising – informing the consumers and producers of the full extent of the costs and benefits of the production/consumption of a good or service to influence their level of demand. This could be advertising through billboards, TV ads, school programmes etc. Example: 5 a day campaign to encourage people to eat more fruit and veg. This should shift the demand outwards towards the MSB, so that consumers internalise the externality of the market. Eval: expensive, people don't like being told what to do/don't listen, may not shift demand as far as desired

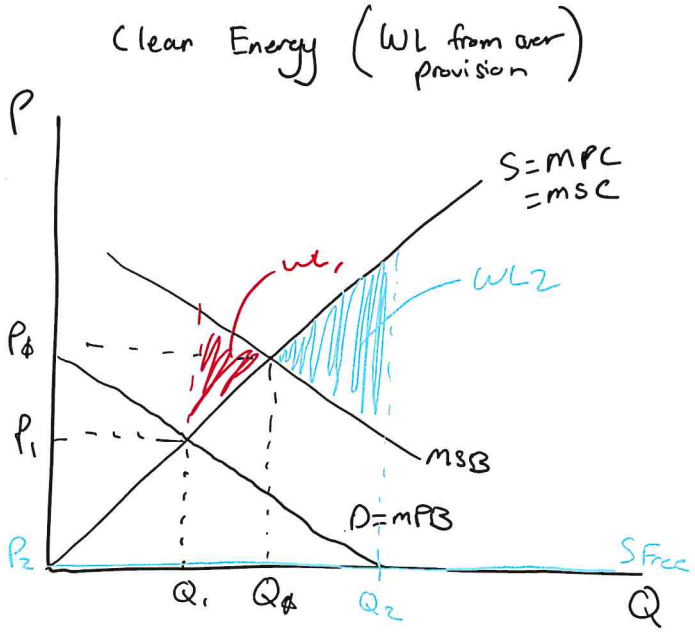


- Subsidy – a government payment to suppliers to encourage them to increase production and lower their prices. The government could subsidise the production of electric vehicles to make them more viable, cheaper alternatives to combustion engine cars. The subsidy will shift a firm's MPC (supply) curve outwards by the distance of the subsidy. This shift outwards will allow the market mechanism to lower the price and encourage more people to consume the good/service at q*, therefore reducing the welfare loss. Eval: expensive for the government, dependent on elasticity of demand, firms may not transfer subsidies onto consumers in the form of lower prices.



- Government Provision (for free) – the government provides the product to the public for free and pays for the all of the costs out of taxpayers money. Eg. Free schooling until 18 and the NHS. If the product is free to consume, then more people will be encouraged to take up consumption of the product due to a lack of price. This increases the public's consumption from q1. Eval: very expensive, government can overprovide the product beyond the social optimum. Unless the externality is enormous then there will be a new large welfare loss





- Behavioural Economics – nudging people to increase their consumption of a merit good based on the irrationality and biases of their decision making. For example: making it the default choice to be an organ donor rather than having to opt in to donate organs. Another example is choice architecture by putting healthy foods in more prominent places in shops and dining halls to encourage more consumption. By nudging people to increase their participation or consumption of a certain product this increases their demand and will shift q1 towards to the social optimum of q*. Eval: people do not like being told what to do or being treated like idiots, may not have much of an effect as there is no price incentive to change behaviour
  Diagram is the same as the education diagram above!

Conclusion:

- Answer the specific question posed
- Rank our policies and possibly say a combination of policies would be most useful
- Many effective policies are expensive to implement by the government and therefore can carry large opportunity costs in spending
- Short Run vs Long Run
- Inequality and Environmental Arguments

Q1.

In the United States, corporate profits since 2010 have averaged 9% of GDP, compared to 5% in the 1990s. This is causing concern that the US economy is increasingly dominated by companies with monopoly power.

Evaluate the view that a firm making low profits must be inefficiently managed.

[25 marks]

Introduction:

- Define low profits – profits are revenue – costs. They are the reward for entrepreneurs for starting businesses. Low profits at the extreme can be interpreted as normal profits (which is where revenue=costs and the firm is making just enough for the entrepreneur not to shut the business down and move to something else)
- Define inefficiencies – x-inefficiency, productive inefficiency (you can also mention allocative or dynamic but they are harder to link to profits/management)
- Monopoly Power is when a firm has over 25% market share and the ability to set prices, and therefore make supernormal profits

Point 1: Yes low profits for monopolies does mean that the firm is inefficiently managed

Either show x-inefficiency on a diagram, or you could show diseconomies of scale. So costs are higher than what they should be, reducing the amount of profit earned by a firm. Some monopolies have no competitive pressure and are incredibly large (Luxottica) and therefore might have wastage in the production process.

Eval: Contestability could be the reason monopolies make normal profits not inefficiencies

Point 2: Perfect Competition (they can't make profit)

Eval: that perfect competition doesn't exist in reality and even in incredibly competitive markets firms can still make supernormal profits in the short run

Point 3: Alternate firm objectives (Sales Max, or sustainability or government run firms)

Draw a sales max diagram and explain the alternate objectives of why a firm might choose not to profit maximise.

Eval: all private firms have to make profits in the long run and you can assume that they are long run profit maximisers even if they are sales max (or sustainability focus) in the short run. eg Uber, Amazon, Google etc. Private companies have to make returns for their shareholders.

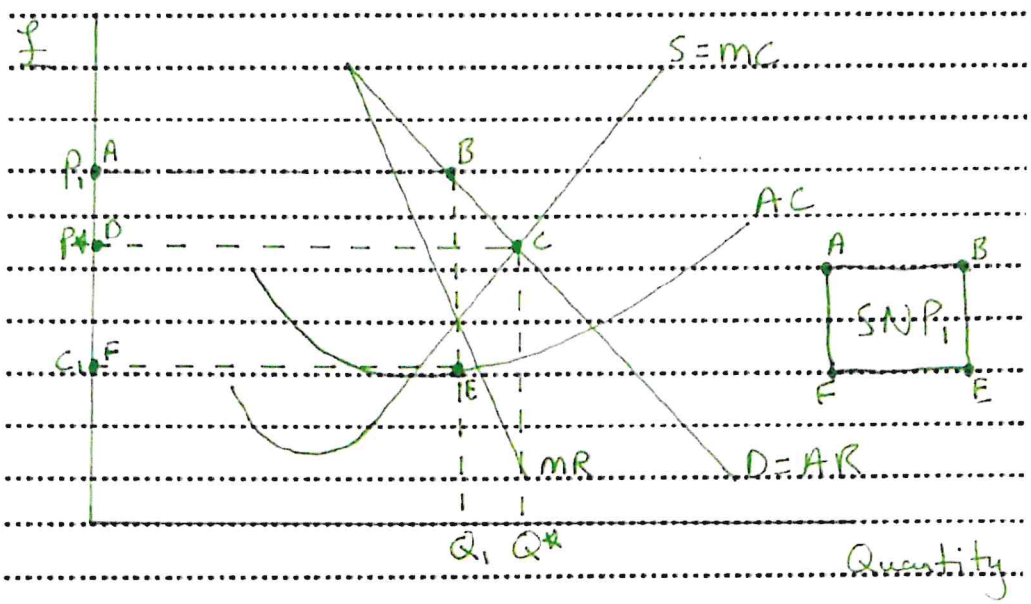
Conclusion:

- MUST is wrong.
- What does the profit making ability of a firm depend on? Is it just inefficient management? Sometimes it is but there are many other external variables which can affect this.

Evaluate the view that consumers are always better off when there is competition in a market rather than a market where a monopoly exists. (25)

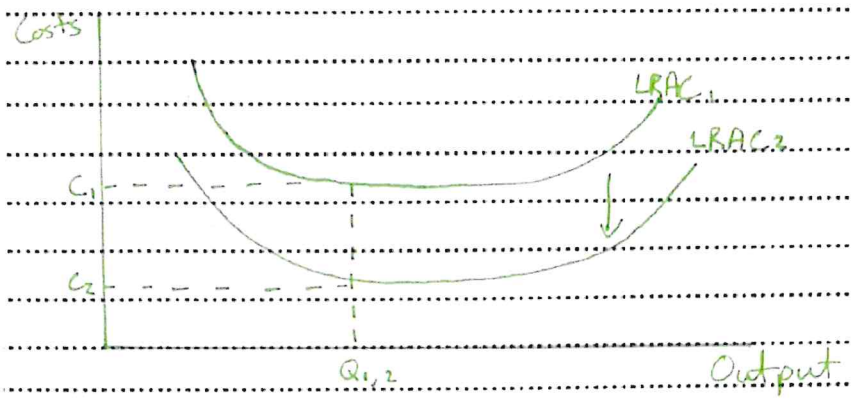
Competition in a market exists where firms do not agree to set prices and compete for customers and market share. Where competition is strongest is in the market structure of perfect competition (PC). Here there are many firms and buyers, homogenous products, low/no barriers to entry, perfect information between producers and consumers, and only normal profits are made in the long run as firms are price takers. In contrast, a monopoly is a market structure with one firm which has over 25% market share, price setting power, and the ability to make supernormal profits. It also has the characteristics of high barriers to entry, imperfect information, and differentiated products. Consumers benefits are usually measured in the size of consumer surplus in the market which increases as prices are lower (usually in PC). However, consumers may also want specialised products and higher quality as well, rather than just solely low prices.

Firstly, consumers are better off in a competitive market rather than a monopoly as the prices in a monopoly are likely to be higher. This is because monopolies have the power to price set and will usually choose to profit maximise at the output where MC=MR on diagram 1. This means that they can raise their prices to P1 and increase their supernormal profits to the size SNP1. Competitive markets will operate where supply (MC) meets demand (AR) at a lower price P*. This means that consumers will have lost consumer surplus of the size ABCD and are worse off. This could be seen in the male shaving market where Gillette have monopoly power and charge high prices for both razors and blades. As there is not much competition, due to high barriers to entry of brand loyalty and shaving technology, they can profit maximise at higher prices than in a market where there are many firms competing for customers.



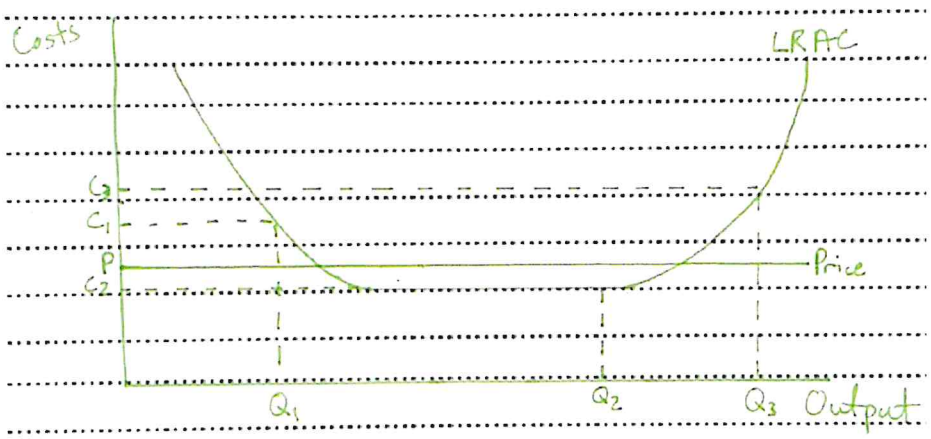
However, monopolies may not always set high prices, as this depends on contestability (the fear of new competition). If a monopoly has high contestability (low barriers to entry) then monopolies will not set high prices at P1 as this may act as a magnet for new firms to join the market. They will instead set low prices to discourage new firms from entering the market.

On the other hand, competitive markets may not be better than monopolies as monopolies can use their supernormal profits (as shown by SNP1 above) to reinvest in research and development and improve their products as well as achieve dynamic efficiencies. As competitive firms only make normal profits, they cannot invest into R&D to innovate and improve the industry for the consumers. If monopolies do invest their supernormal profits effectively, this would reduce their costs over time as shown below where LRAC1 has shifted down to LRAC2, reducing costs from C1 to C2. If these reduced costs lead to reduced prices as well then consumers will actually benefit from monopolies existing as PC firms would not be able to reduce costs over time. A good example of this is the smartphone industry where both Samsung and Apple have monopoly power. Even though they make lots of profit, they have reduced the real costs of smartphones over time as well as consistently improving the technology of their devices. Consumers have benefited hugely from this.



However, not all monopolies may choose to reinvest their supernormal profits into R&D and even if they can reduce costs they may not pass on these savings to consumers. They could just increase their profit margins by reducing costs but keeping prices high due to a lack of alternative products for consumers.

Finally, monopolies may be better for consumers than competitive markets in industries where there are large, fixed costs and therefore economies of scale. This is most prevalent in natural monopolies where the market is only efficient if there is one firm operating due to the duplication of capital investment, eg TfL. In industries with large, fixed costs such as airlines, water provision, and pharmaceuticals it makes sense for large monopolies to exist as they can reduce the average cost per unit through economies of scale. They can bulk buy resources, hire better managers, and spread risk to reduce the cost per unit compared to smaller firms. For example, Ryanair can order 100s of planes at a time and use machinery for check in to cut costs and pass this onto consumers with very low prices. This is shown on the below diagram where competitive firms operate at Q1C1 and a monopoly, which is larger, operates at Q2C2. These lower costs can be passed onto consumer through lower prices. For example, the price (P) could only be offered by the monopoly as it is below the cost of competitive firms, which means that they will make a loss.



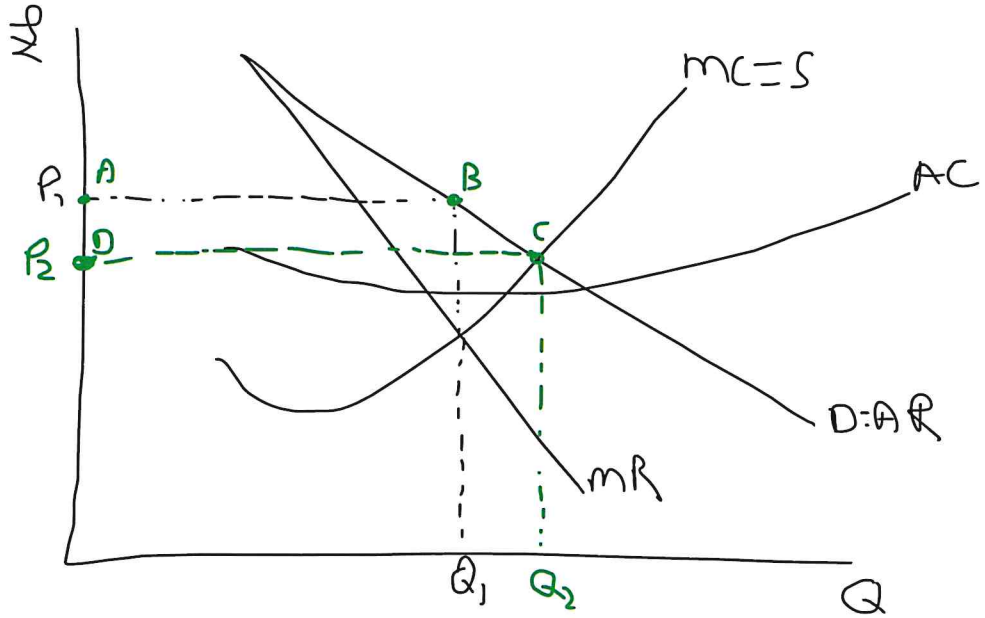
However, firms that are too large may in fact have diseconomies of scale rather than economies of scale. If the monopoly firm grows too large there may be communication issues, motivational fatigue, and a geographically overstretched business model. This will actually increase costs to C3, which is higher than the competitive market cost and would mean consumers would not benefit from a monopoly market structure.

To conclude, the statement “consumers are always better off when there is competition” is false. There are instances where competition would not benefit consumers. Large firms like the NHS, Pfizer, and Apple provide benefits to consumers that smaller competitive firms cannot through investment and economies of scale. The extent to which consumers would prefer a competitive market or a monopoly depends on the scope and scale of economies of scale as well as the ability for firms making supernormal profits to create dynamic efficiencies. In markets such as restaurants and clothing consumers may want competition so that they can access lower prices and more choice between competing firms. One, monopoly restaurant would not be beneficial for the UK economy and the consumers in it. Lastly, contestability has a large role to play. If a monopoly is contestable, the firm may achieve economies of scale and continue to set low prices in fear of new firms competing for their customers. Google search has 97% of the UK market but has been free for 20+ years and for many is still the best product in the market benefitting consumers.

Nationalisation vs Privatisation 25 mark essay plan

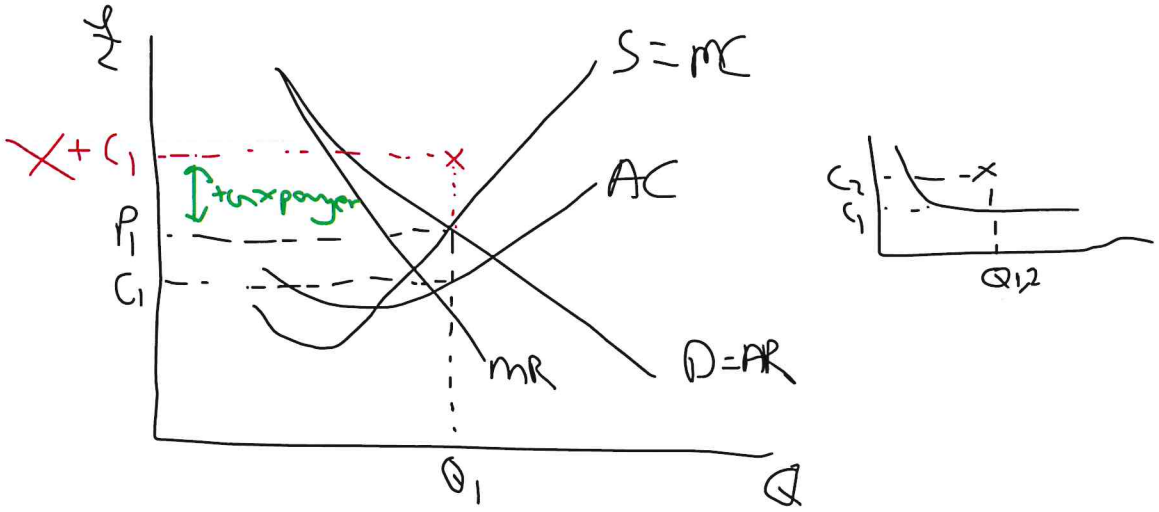
Bringing back private assets or companies into the public sector is called renationalisation. This is where the government would control and run the electricity sector within the UK. Currently the electricity industry runs as a privatised oligopoly with the "big 6" firms controlling the industry. Oligopolies are markets with 3-6 large firms, price setting power, differentiated goods, barriers to entry, and firms can make supernormal profits. However, as electricity is deemed as a necessity within the UK, it is heavily regulated by OFGEM and the CMA so that consumers are not taken advantage of.

One argument for renationalisation is that prices are currently too high for consumers and by bringing the industry back into the public sector will allow for the government to reduce prices. Oligopoly firms are likely to try and maximise profits at MC=MR and therefore set prices at P1. This can be shown in Extract A where the average price rises from 2010-2012 was 23.6% even though costs of generating electricity on rose by 3.2%. This can be seen as price gouging due to the lack of competition in the privatised market. This creates a welfare loss in society as consumers cannot buy as much electricity as they would like and this may push certain members of the economy into poverty. By nationalising, the firms' aim would move to welfare maximising rather at the social optimum point (AC=MR) instead of profit max. This should push prices down from P1 to P2 and increase the quantity of electricity consumed from Q1 to Q2. This would remove the welfare loss and increase CS by the area ABCD.



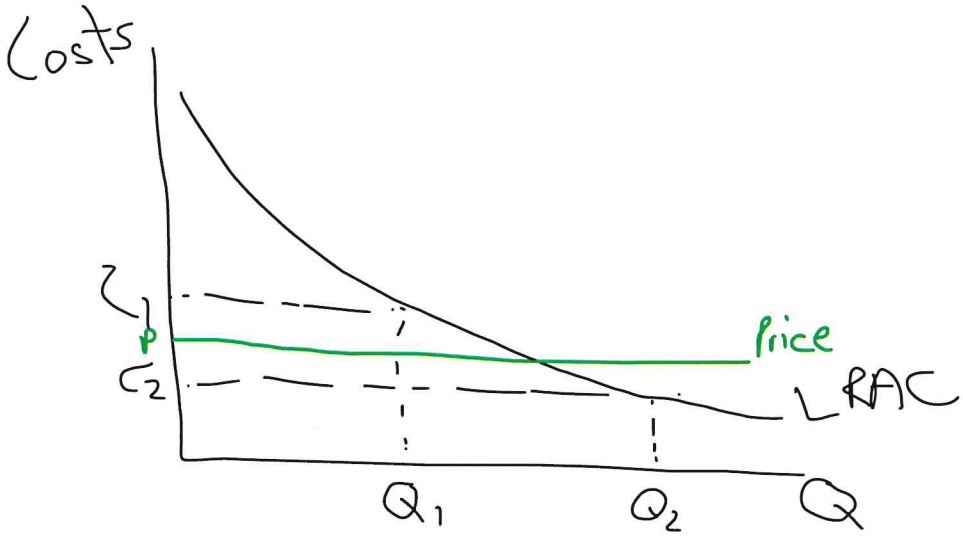
However, the electricity industry is already heavily regulated by OFGEM and firms do not have much control over their price setting power. Instead of nationalising, we could be more aggressive in setting lower price caps for the private firms so that they do not raise prices all the way to P1.

An argument against nationalisation is that government run industries can be inefficient. Without a profit incentive there may be x-inefficiencies associated with the running of nationalised industries. With no competition and the safety of taxpayer subsidies if a nationalised firm makes a loss, employees and managers of publicly run firms do not have the right incentives to increase efficiencies, cut costs, and improve the operation of the business. This can be shown in Extract B where it states that there were "aims of increasing competition, efficiency, and investment." This can be shown on the diagram below where the nationalised firm is aiming to operate at the socially optimum output (AR=MC) at price P1 and costs C1. However, with inefficiencies around laziness, wastage, and a lack of profit incentive, costs may rise to C1 + x-inefficiency. This means that the nationalised firm is now making a loss and the taxpayer has to cover this with a subsidy.



However, on the other hand, we could align the public sector pay with cost savings. If employees and managers are incentivised correctly (with bonuses or performance related pay) this may reduce the principal-agent problem and reduce x-inefficiencies within a nationalised electricity industry.

Finally, nationalisation may be a good idea because the electricity industry could be viewed as a natural monopoly. This is a market structure with incredibly high fixed and sunk costs which means that operating multiple firms could increase average costs due to the inefficient duplication of capital equipment. For example, we only have one national grid to transport energy and therefore we would never have a truly competitive private market because new firms are not going to set up their own electricity grids due to the costs. This can be shown on an LRAC diagram where a large nationalised firm can operate at Q2 with lower costs of C2 vs smaller private firms at Q1C1. This would allow them to set lower prices at Price P below the costs of private firms. The economies of scale arise from the lack of needing to spend on duplicate capital equipment and managerial efficiencies.



However, a nationalised industry may in fact suffer from diseconomies of scale. While arguments do exist that electricity generation is a natural monopoly, a company may become too stretched across the entire country (geographical diseconomies) and costs may actually increase due to the size and scale of the business.

To conclude, the arguments over whether the electricity industry should be renationalised centre around increased efficiencies vs price increases. In theory, privatisation with competition (or contestability) should bring around lower costs and therefore lower prices as well. It could also allow for dynamic efficiencies through the investment of supernormal profits into new infrastructure and technology as well. In reality though, private firms need to be heavily regulated in the energy industry as shown by price increases and these costs of regulation may outweigh any efficiency savings created by privatisation. The best policy may be to renationalise the energy industry, but align pay and rewards for those working in the industry with greater efficiency gains and incentives around investment of profit into new technology and green energy.

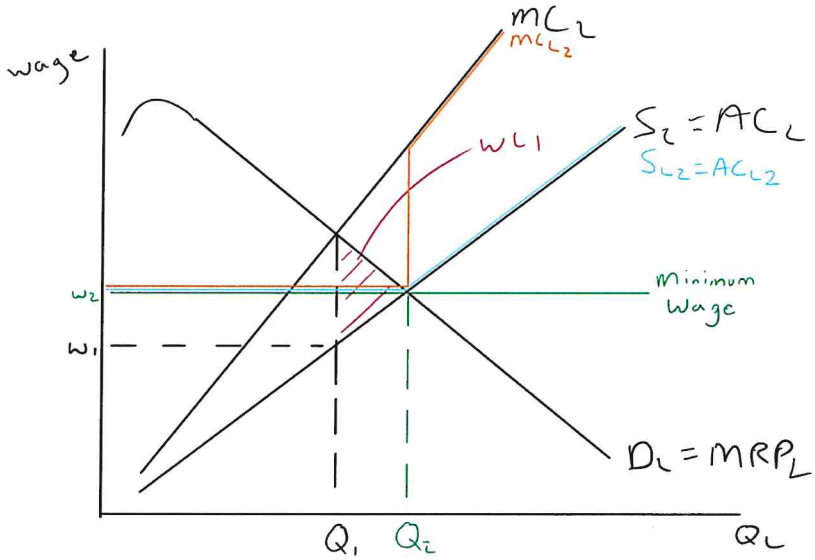
Evaluate the case that a Trade Union or higher National Minimum Wage is good for society.

Introduction:

- Trade Union – an organisation of workers who group together to bargain for higher wages, better working conditions, and training/education. They do this through collective bargaining power
- National Minimum Wage – the legal minimum amount a firm can pay its employees per hour. £9.50 for 23+.
- National Living Wage – the minimum amount a person can earn an hour to sustain a good standard of living in a given area. London - £11.05. UK - £9.90. This is calculated based on the costs of living in a given area.
- Both Trade Unions and Minimum Wages aim to increase the wages of the lowest paid and reward them more fairly for the work they carry out.

Paragraph 1: Trade Unions/NMW can both increase wages and employment in a Monopsony market

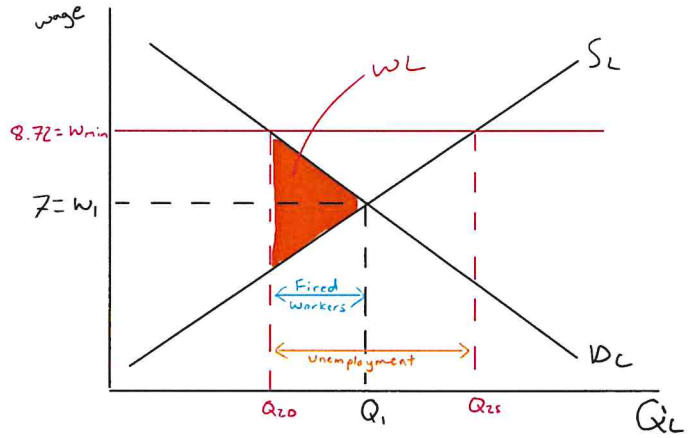
- Monopsony – a labour market where there is one dominant buyer of labour and therefore the firm is a wage setter not a wage taker



- In a monopsony, the firm is a profit maximiser so therefore hires workers at the point where MCL=MRPL. At this point the profit per worker is maximised. This is at Q1, and they pay a low wage of w1 because at Q1, w1 is SL and therefore the wage workers are willing to work at
- An introduction of a trade union (or higher min wage) would use bargaining power to ask for a higher minimum wage that all employees will be paid at. They can do this due to the collective power of workers forming a Monopoly supply of labour. This creates a minimum wage as shown on the diagram
- Due to this introduction of a trade union/min wage there is a wage (w2) which workers will not be paid below. This means that the MCL curve is now flat along the minimum wage until ACL>min wage. Then it jumps up and reconnects with the original MCL curve. The new MCL=MRPL equilibrium is at Q2, w2.
- This can be seen as a good policy because workers wages increase, more workers are hired, and welfare loss is eradicated
- Evaluation: While employment does increase in the short run, this higher wage will make capital investment more appealing to the firm and they might choose to replace labour with capital in the long run, increasing unemployment

Paragraph 2: Trade Unions and Minimum Wage can create higher unemployment in a perfectly competitive labour market

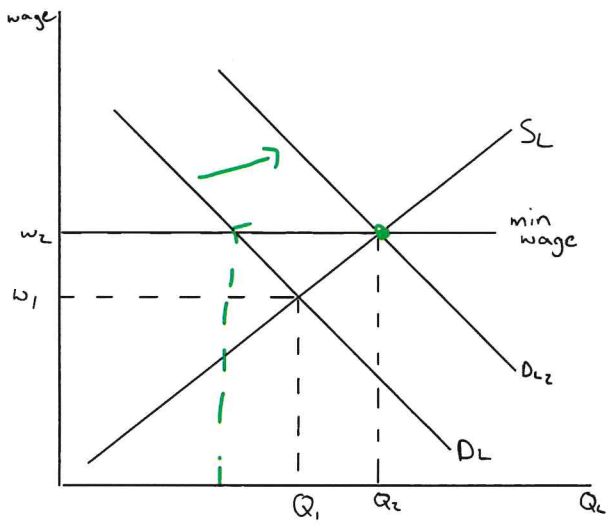
- Perfectly Competitive Labour Market – Lots of firms and workers, no barriers to entry/exit, everyone has perfect information, workers all have similar skill levels, firms are wage takers not wage makers, the quantity of workers hired and the wage they get paid are determined by the SL and DL



- Before the trade union/minimum wage, the quantity of workers in the market is at Q1 and the wage they are earning is at w1 (£7 an hour). For example this could be workers in shoe factories in the UK. The wage and quantity is set where the Supply of Labour = Demand for Labour
- The introduction of a TU or Min Wage has to increase the wage above w1. This can be shown by the line wmin at £8.72 an hour. Here the quantity Demanded of Labour falls from Q1 to Q2D. This means that the workers between Q1 and Q2D are fired. This is because the firm can no longer afford to keep them on and might replace them with machines. Also, the SL increases from Q1 to Q2S because the higher wage incentivises more people to enter the labour market
- This creates a welfare loss shown on the diagram and unemployment of Q2D to Q2S.
- Evaluation: It is unlikely that there are many perfectly competitive labour markets so this situation is unlikely to occur and also if the DL and SL are more inelastic, the benefits of higher wages might outweigh the costs of unemployment because the amount of unemployment will be smaller

Paragraph 3: Efficiency Wage Theory or Training + Education from Trade Union increases productivity

- Efficiency Wage Theory – when workers are paid a higher wage, they will feel more motivated to work hard, increasing their productivity and therefore their Marginal Revenue Product of Labour (each worker can produce more and therefore make the firm more money)
- Trade Unions can pay and provide training and education for their workers which will increase their productivity and do the same as above



- With the introduction of a minimum wage, the higher wage w2 can incentivise workers to increase their productivity and therefore the Marginal Product of Labour they bring to a firm. This increases the DL from DL to DL2. The new equilibrium at w2 is where SL and DL meet, therefore both wages have increased and the quantity of workers has increased too
- With Trade Unions you would not draw in a min wage, and just shift DL outwards due to increased productivity from training and education.
- Evaluation for Min Wage: In low skill, low wage jobs, the wage efficiency theory might have some limitations. The increased productivity from being paid more could be minimal and therefore there would still be unemployment from the minimum wage. Eg. McDonalds, how many more burgers could a motivated worker actually make.
- Evaluation: Training and education costs money, this usually has to come from the firms and therefore might have less money to pay workers. Also, if workers become more skilled then they might look to leave the industry and move on to higher paying jobs, creating a gap in that market.

Conclusion:

- Overall, we think that the national minimum wage increasing is a good thing because many markets (especially those with low paid workers) are monopsonies or the firms in them have monopsony power. Therefore it is likely the workers are being under paid and need protection
- While in PC markets, unemployment can increase, this is dependent on elasticities and the wage efficiency theory which could mean unemployment doesn't actually increase
- However, in the long run too much trade union power or too high an increase in the minimum wage will incentivise firms to invest in more capital and hire less workers over time

10 marks: evaluate the benefits of inequality within society.

Income is the flow of earnings to an individual and wealth is the total quantity of assets owned by someone. Inequality is the difference between groups of people in terms of how much income they earn or assets they own.

Inequality occurs in all modern capitalist economies; the alternative is communism and the majority of economist argue that this cannot work. "Inequality reflects different levels of talent and effort among individuals". This means that with inequality there is more incentive for people to work harder, undertake more education and training, and feel like their skills and efforts are being rewarded. This will increase productivity of the workforce as they will have more human capital (from the education and training undertaken) and are more eager to work harder. For example, becoming a lawyer is a long, difficult process and many people only undertake it because of the relatively high earnings that lawyers make. Without inequality there are likely to be skills gaps in key jobs (doctors, airline pilots, bankers, lawyers) and the economy will be less able to get the most suitable people into the right jobs. Without inequality, we might see the economy stagnate and the standard of living for all drop as well.

However, there are many issues with the current levels of inequality. Firstly, with high levels of inequality also comes poverty. As said in the extract, many countries are suffering from high levels of poverty since the global financial crisis and one way to reduce poverty is to lessen the inequality gap. Secondly, high levels of inequality actually reduce productivity as people from lower income backgrounds feel that hard work and skill isn't enough to improve their earning potential. This can create marginalised communities and overall a fall in productivity for the economy. Finally, high levels of inequality in developed countries creates more crime and worse health. This means that the government has to increase spending on policing, healthcare, and the welfare state. There is either an opportunity cost of this spending (away from long term productivity gains) or taxes have to be raised to fund this.