Qualification Accredited

OCR
Oxford Cambridge and RSA

**A LEVEL**
*Exemplar Candidate Work*

# ECONOMICS

H460
For first teaching in 2015

## Component 1
## Microeconomics

Version 3


www.ocr.org.uk/economics

# Contents

# Introduction

We produced two 25-mark extended response questions for A Level Microeconomics (H460/01) and asked students to answer it.

The sample answers in this resource have been extracted from original candidate work to maintain their authenticity.

To facilitate different ways for using this resource, you will find the student answers twice, once without and then with examiner comments and marks.

Please note that this resource is provided for advice and guidance only and does not in any way constitute an indication of grade boundaries or endorsed answers.

OCR
Oxford Cambridge and RSA

**…day June 20XX – Morning/Afternoon**

**A Level in Economics**

**H460/01 Microeconomics**

# PRACTICE MARK SCHEME

## MARKING INSTRUCTIONS

| Descriptor | Award mark |
|---|---|
| On the borderline of this level and the one below | At bottom of level |
| Just enough achievement on balance for this level | Above bottom and either below middle or at middle of level (depending on number of marks available) |
| Meets the criteria but with some slight inconsistency | Above middle and either below top of level or at middle of level (depending on number of marks available) |
| Consistently meets the criteria for this level | At top of level |

## Levels of response – Level descriptors

| | Knowledge and understanding/ Application | Analysis | Evaluation |
|---|---|---|---|
| **Strong**<br>**Good** | Precision in the use of the terms in the question and applied in a focused way to the context of the question. | Strong: An explanation of causes and consequences, fully developing the links in the chain of argument.<br>Good: An explanation of causes and consequences, developing most of the links in the chain of argument. | Strong: A conclusion is drawn weighing up both sides, and reaches a supported judgement.<br>Good: A conclusion is drawn weighing up both sides, but without reaching a supported judgement. |
| **Reasonable** | Awareness of the meaning of the terms in the question and applied to the context of the question. | An explanation of causes and consequences, which omit some key links in the chain of argument. | Some attempt to come to a conclusion, which shows some recognition of the influencing factors. |
| **Limited** | Awareness of the meaning of the terms in the question. | Simple statement(s) of cause and consequence. | An unsupported assertion. |

<table>
<tr><th colspan="3">Question</th><th>Answer</th><th>Marks</th><th>Guidance</th></tr>
<tr>
<td>2</td>
<td>*</td>
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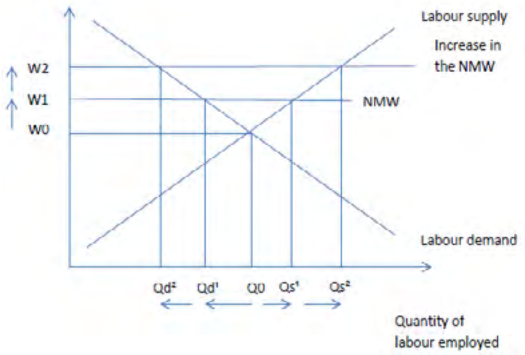
<td>
The UK national minimum wage is set to increase by 20p to £6.70 in 2015 and the living wage is being introduced by more firms each year. The expectation is that this will result in greater employment and labour market participation.<br><br>
Evaluate, with the aid of a diagram, whether, the increase in the national minimum wage is the key to increasing UK employment?<br><br>
Level 5 (21–25 marks)<br><br>
Good knowledge and understanding of the minimum wage and employment.<br><br>
Strong analysis of the link between an increase in the national minimum wage and employment. A relevant and accurately drawn and labelled diagram is provided and linked to the analysis.<br><br>
Strong evaluation including a supported judgement on whether an increase in the national minimum wage is the key to increasing UK employment.<br><br>
There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.<br><br>
Level 4 (16–20 marks)<br><br>
Good knowledge and understanding of the national minimum wage and employment.<br><br>
Strong analysis of the link between increasing the national minimum wage and increasing UK employment levels.<br><br>
A relevant and accurately drawn and labelled diagram is provided and linked to the analysis.<br><br>
Good evaluation on whether increasing the national minimum wage is key to increasing UK employment but without considering whether it is the key.<br><br>
There is a well-developed line of reasoning which is clear and logically structured. The information presented is relevant and in the most part substantiated.<br><br>
Level 3 (11–15 marks)<br><br>
Good knowledge and understanding of the national minimum wage and employment.<br><br>
Good analysis of the link between increasing the national minimum wage and increasing UK employment levels.<br><br>
A relevant diagram is provided and linked to the analysis.<br><br>
Reasonable evaluation on whether increasing the national minimum wage will increase UK employment but without considering whether it is key.
</td>
<td>25<br>(AO1 x6<br>AO2 x 6<br>AO3 x6<br>AO4 x7)</td>
<td>
Indicative content<br>
• The national minimum wage is a pay floor which wages are unable to fall below. An increase in the national minimum wage would increase this pay floor. It is commonly thought that the UK's NMW is currently below the labour market equilibrium and the average wage rate.<br><br>
Use and interpretation of a minimum wage diagram showing the NMW increasing:<br>

<br>
Reasons why it may result in an increase in UK employment:<br><br>
Creates an incentive to re-enter the labour market and so increases the labour participation rate and the number of economically active people, labour supply has increased from Qs1 to Qs2, therefore vacancies are more likely to be filled.<br><br>
Fewer people wish to be on benefits and so this will free up government expenditure for job creation schemes which would then provide opportunities for those who have entered the labour market.<br><br>
Workers may be more productive if they're being paid a higher wage and a rise in their MRP will increase demand for labour and so increase UK employment.<br><br>
Higher wage rates could increase consumption and so increase (derived) demand for labour, resulting in an increase in UK employment.<br><br>
Reasons why it may not result in an increase in UK employment:<br>
• An increase in the NMW will increase excess supply of labour as quantity of labour supply increases from Qs1 to Qs2 but labour demand falls from Qd1 to Qd2 as the marginal cost of labour has risen without any rise in MRP.<br>
• Employers may not be able to afford to pay the higher minimum wage and so will lay workers off creating less UK employment.<br>
• The increase in the wage rate may not be enough to create an incentive to actively seek work and find employment.
</td>
</tr>
</table>

| Question | | | Answer | Marks | Guidance |
|---|---|---|---|---|---|
| | | | There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.<br><br>**Level 2 (6–10 marks)**<br><br>**Good** knowledge and understanding of the national minimum wage and/or employment.<br><br>**Reasonable** analysis of the link between (increasing) the national minimum wage and UK employment. A diagram is included which is less than perfect.<br><br>**Reasonable** evaluation on whether the national minimum wage will increase UK employment but without considering whether it is the key and candidates may not consider the increase in the national minimum wage.<br><br>The information has some relevance, but is communicated in an unstructured way.<br><br>The information is supported by limited evidence, the relationship to the evidence may not be clear.<br><br>**Level 1 (1–5 marks)**<br><br>**Reasonable** knowledge and understanding of the national minimum wage and/or employment. Candidates may explain unemployment.<br><br>**Limited** analysis of the link between the national minimum wage and employment/ unemployment.<br><br>**Limited or no** evaluation.<br><br>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.<br><br>**0 marks** no response or no response worthy of credit. | | • The increase in the NMW will incentivise workers to enter the labour market but there may be too few jobs available and so actually increase unemployment and do nothing to change employment levels.<br><br>Credit, where appropriate, knowledge/analysis of other, relevant factors.<br><br>Possible routes into evaluation:<br><br>• Where is the national minimum wage in relation to the equilibrium wage rate, will it significantly increase the marginal (and average) cost of hiring labour?<br>• How flexible are labour markets, can labour be hired and fired easily?<br>• Depends on the size of the increase in the national minimum wage.<br>• Depends on the mobility of labour (occupational and geographical) – can workers access to job vacancies.<br>• Are jobs created to absorb the increase in supply of labour or is there excess supply? |

| Question | | | Answer | Marks | Guidance |
|---|---|---|---|---|---|
| 3 | * | | A view held by some economists is that profit maximisation is no longer relevant and that firms are seeking to be more socially responsible in their behaviour.<br>Evaluate whether profit maximisation is still a realistic economic objective for firms.<br><br>**Level 5 (21–25 marks)**<br>**Good** knowledge and understanding of economic objectives and the behaviour of firms.<br>**Strong** analysis of whether profit maximisation is still a realistic economic objective for firms.<br>**Strong** evaluation, including a supported judgement, of whether profit maximisation is still a realistic economic objective for firms.<br>There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.<br><br>**Level 4 (16–20 marks)**<br>**Good** knowledge and understanding of economic objectives and the behaviour of firms.<br>**Strong** analysis of whether profit maximisation is still a realistic objective for firms.<br>**Good** evaluation of whether profit maximisation is still a realistic economic objective for firms without a supported judgement.<br>There is a well-developed line of reasoning which is clear and logically structured. The information presented is relevant and in the most part substantiated.<br><br>**Level 3 (11–15 marks)**<br>**Good** knowledge and understanding of economic objectives and the behaviour of firms.<br>**Good** analysis of whether profit maximisation is still a realistic objective for firms. .<br>**Reasonable** evaluation of whether profit maximisation is a realistic economic objective for firms without considering whether it is **still** realistic.<br>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence. | | Indicative content<br>• Profit maximisation is found when MR=MC.<br>• There are a number of alternative economic objectives firms may hold: sales revenue maximisation, sales volume maximisation, corporate social responsibility, growth maximisation, utility maximization, profit satisficing, social welfare.<br>There are a number of diagrams candidates could use in their answer. This question doesn't specify that a diagram is required and so candidates shouldn't be penalised if they don't use one, although it can be helpful to further their analysis.<br>Reasons why it may profit maximisation is still a realistic economic objective:<br>• Profit maximisation is a realistic objective for limited firms who need to maintain shareholder satisfaction.<br>• Profit maximisation is still realistic because it profit provides the internal finance required for growth.<br>• In a perfectly competitive market firms will produce a profit maximising level of output, if they don't they won't survive in their market.<br>• The behaviour of a monopolist will often be to maximise profits as there is little (or no) competition to necessitate other economic objectives being needed.<br>Reasons why it might not (inevitably) improve macroeconomic performance:<br>• Pressure from consumers who are more socially conscious may force a firm to abandon profit maximisation for social welfare or for CSR as a more realistic objective.<br>• An increase in competition (and a reduction in the market concentration ratio) will change the economic objective of an incumbent firm to sales revenue or sales volume maximisation rather than profit maximisation if they're to maintain their position on the market.<br>• If a market becomes more contestable, a monopolist may sacrifice profit maximisation for a more realistic objective such as sales volume maximisation or growth.<br>• If stakeholders, such as employees, gain power, a firm may opt for profit satisficing in order to increase wage rates/improving working conditions etc… |

| Question | | | Answer | Marks | Guidance |
|---|---|---|---|---|---|
| | | | **Level 2 (6–10 marks)**<br>**Good** knowledge and understanding of economic objectives and the behaviour of firms.<br>**Reasonable** analysis of whether profit maximisation is still a realistic objective for firms. .<br>**Reasonable** evaluation of whether profit maximisation is a realistic economic objective for firms without considering whether it is still realistic.<br>The information has some relevance, but is communicated in an unstructured way.<br>The information is supported by limited evidence, the relationship to the evidence may not be clear.<br><br>**Level 1 (1–5 marks)**<br>**Reasonable** knowledge and understanding of economic objectives and the behaviour of firms.<br>**Limited** analysis of whether profit maximisation is still a realistic objective for firms. Te diagram may not be relevant, may be inaccurate or may be missing.<br>**Limited or no** evaluation.<br>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.<br>**0 marks** no response or no response worthy of credit. | | Credit, where appropriate, knowledge/analysis of other, relevant factors.<br>Possible routes into evaluation:<br>• depends upon what (if anything) has changed in the market conditions to render profit maximisation no longer realistic.<br>• depends on how an incumbent firm responds to changes in their market – do they feel any need to alter their behaviour?<br>• Depends on the market structure; oligopolists may never seek to maximise profit but to maximise utility or aim to be socially responsible in order to differentiate themselves from their rivals. |

| Question | AO1 | AO2 | AO3 | AO4 | TOTAL | (Quantitative Skills) |
|---|---|---|---|---|---|---|
| 2/3 | 6 (2) | 6 (2) | 6 (2) | 7 (2) | **25** | **(8)** |
| **TOTAL** | **12 (4)** | **12 (4)** | **12 (4)** | **14 (4)** | **50** | **(16)** |

# QUESTION 2

**The national minimum wage is set to increase by 20p to £6.70 in 2015 and more firms are introducing the living wage each year. The expectation is that this will result in greater employment and labour market participation.**

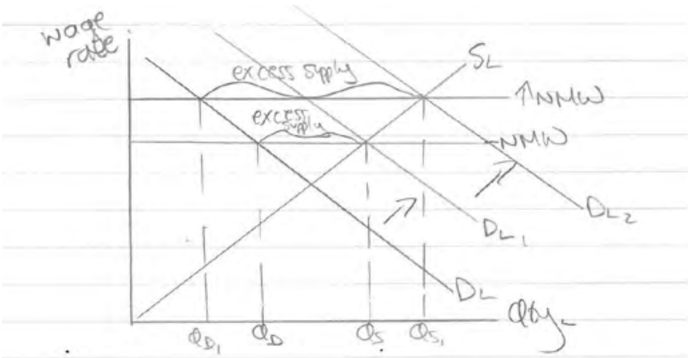
**Evaluate, with the aid of a diagram, whether, the increase in national minimum wage is the key to increasing UK employment. [25 marks]**

# CANDIDATE RESPONSE

## Candidate A – UNANNOTATED

The rate of employment is defined as the percentage of those people in a population who are willing and able to work and subsequently have a job. The minimum wage is the least amount of money any firm within an economy can legally pay a worker. Unions often use collective bargaining power to increase the wages of their members, recently an example being the main firemen's national union. Governments will then implement a legal minimum wage. It remains questionable if this will actively increase labour market participation due to the fact that firms may not be able to afford the new workers. On the other hand, workers will be a lot more incentivised to enter the labour market as they will be paid a greater wage. Often the extent of an increase in minimum wage on employment levels will depend upon the ability of a firm to pay the increased wage of each worker and this is dependent on an array of variables.

Often, by increasing the national minimum wage in an economy, there will be a greater incentive to work. This is because the opportunity cost of not working becomes greater and people have the opportunity to earn more money that can be used as disposable income, therefore increasing economic welfare. This means that those who are voluntarily unemployed will enter the labour market in order to earn more money. There could also be an increase in labour productivity as workers are more motivated through the higher wage rate. Therefore, if marginal physical product increases so will the marginal revenue product of labour, thus increasing demand for labour. The diagram below shows this through a shift to the right in the demand curve from D1 – D2 and the excess supply of labour normally created by a pay floor, such as the national minimum wage will be soaked up to reach a new equilibrium in the market.




In some cases, the good that the worker is producing may be price elastic and any change in price of the good will lead to a disproportional change in demand. This would mean that the firm could not pass on the extra cost of the worker to the consumer, but instead would have to employ less workers if they were legally bound to pay each worker at a certain wage rate. This would lead to a fall in participation in the labour market.

This depends to what extent minimum wage is increased. If it is only increased marginally by a couple of pence, then firms may be able to absorb the costs without passing any costs onto the consumer. Similarly, firms may be subsidised by the government by employment schemes to pay each worker, and therefore, the increase in wage does not cost either the firm or the consumer at all, and an increase in participation in the labour market could be seen.

# Candidate A – UNANNOTATED (Cont)

On the other hand, if firms decide to enforce the living wage, this may see a large increase in labour market participation, as those living out of the region may commute to the area where the regional living wage is being enforced. This could lead to a decrease in labour market participation in other regions. This is because less people want to work for a wage that is lower than a regional living wage. For example, those outside of the M25 may commute in to the M25 to gain the London living wage, but the regional labour market participation outside of the M25 will severely decrease. This increase in wage in one area can have an opportunity cost in terms of labour market participation in another area. However, this depends upon the geographical mobility of the labour as if the workers can't get to one region, they will be forced to stay in their own region and work for the respective lower wage.

In conclusion, whilst in some labour markets, the increase in minimum wage will certainly incentivise an increase in labour market participation and so could be key to increasing employment, in others it may not. This is due to the fact that firms may not be able to employ as many workers with the new wage, and therefore, will only be able to employ less workers. On the other hand, if the cost of employing these new workers can be absorbed, then there is no reason why more workers can't be employed at this higher wage and therefore it could be key for those industries. To combat this, the government should increase the minimum wage in small amounts so the costs can be absorbed by the firm, or passed on in small amounts to the consumer. In the long term, it is probably best to consider supply side policies as well in order to help the labour market be more flexible, labour needs to be occupationally and geographically mobile if voluntary unemployment is going to be reduced and alongside that (especially for those on a lower income and therefore more likely to be paid the minimum wage), an increase in the initial tax threshold to increase disposable incomes.

# QUESTION 2

**The national minimum wage is set to increase by 20p to £6.70 in 2015 and more firms are introducing the living wage each year. The expectation is that this will result in greater employment and labour market participation.**

**Evaluate, with the aid of a diagram, whether, the increase in national minimum wage is the key to increasing UK employment. [25 marks]**

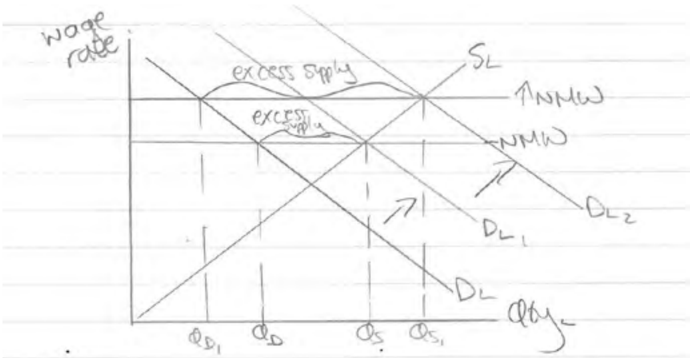
# CANDIDATE RESPONSE

## Candidate A – ANNOTATED

The rate of employment is defined as the percentage of those people in a population who are willing and able to work and subsequently have a job. The minimum wage is the least amount of money any firm within an economy can legally pay a worker. Unions often use collective bargaining power to increase the wages of their members, recently an example being the main firemen's national union. Governments will then implement a legal minimum wage. It remains questionable if this will actively increase labour market participation due to the fact that firms may not be able to afford the new workers. On the other hand, workers will be a lot more incentivised to enter the labour market as they will be paid a greater wage. Often the extent of an increase in minimum wage on employment levels will depend upon the ability of a firm to pay the increased wage of each worker and this is dependent on an array of variables.

*Good introduction to the question: whether an increase in the national minimum wage will increase UK employment.*

Often, by increasing the national minimum wage in an economy, there will be a greater incentive to work. This is because the opportunity cost of not working becomes greater and people have the opportunity to earn more money that can be used as disposable income, therefore increasing economic welfare. This means that those who are voluntarily unemployed will enter the labour market in order to earn more money. There could also be an increase in labour productivity as workers are more motivated through the higher wage rate. Therefore, if marginal physical product increases so will the marginal revenue product of labour, thus increasing demand for labour. The diagram below shows this through a shift to the right in the demand curve from D1 – D2 and the excess supply of labour normally created by a pay floor, such as the national minimum wage will be soaked up to reach a new equilibrium in the market.




In some cases, the good that the worker is producing may be price elastic and any change in price of the good will lead to a disproportional change in demand. This would mean that the firm could not pass on the extra cost of the worker to the consumer, but instead would have to employ less workers if they were legally bound to pay each worker at a certain wage rate. This would lead to a fall in participation in the labour market.

*Good analysis of the reasons why an increase in the minimum wage rate wouldn't result in an increase in employment.*

This depends to what extent minimum wage is increased. If it is only increased marginally by a couple of pence, then firms may be able to absorb the costs without passing any costs onto the consumer. Similarly, firms may be subsidised by the government by employment schemes to pay each worker, and therefore, the increase in wage does not cost either the firm or the consumer at all, and an increase in participation in the labour market could be seen.

*Good discussion of the extent to which employment may be affected by an increase in the minimum wage.*

# Candidate A – ANNOTATED (Cont)

On the other hand, if firms decide to enforce the living wage, this may see a large increase in labour market participation, as those living out of the region may commute to the area where the regional living wage is being enforced. This could lead to a decrease in labour market participation in other regions. This is because less people want to work for a wage that is lower than a regional living wage. For example, those outside of the M25 may commute in to the M25 to gain the London living wage, but the regional labour market participation outside of the M25 will severely decrease. This increase in wage in one area can have an opportunity cost in terms of labour market participation in another area. However, this depends upon the geographical mobility of the labour as if the workers can't get to one region, they will be forced to stay in their own region and work for the respective lower wage.

*Further evaluation of the impact an increase in wages, the candidate considers the more recent introduction of a living wage.*

In conclusion, whilst in some labour markets, the increase in minimum wage will certainly incentivise an increase in labour market participation and so could be key to increasing employment, in others it may not. This is due to the fact that firms may not be able to employ as many workers with the new wage, and therefore, will only be able to employ less workers. On the other hand, if the cost of employing these new workers can be absorbed, then there is no reason why more workers can't be employed at this higher wage and therefore it could be key for those industries. To combat this, the government should increase the minimum wage in small amounts so the costs can be absorbed by the firm, or passed on in small amounts to the consumer. In the long term, it is probably best to consider supply side policies as well in order to help the labour market be more flexible, labour needs to be occupationally and geographically mobile if voluntary unemployment is going to be reduced and alongside that (especially for those on a lower income and therefore more likely to be paid the minimum wage), an increase in the initial tax threshold to increase disposable incomes.

*Supported judgement on the fact that there will be greater labour participation and so employment in certain markets. The candidate takes this further to consider how the government should act in order to avoid some of the possible problems caused by an increase in the national minimum wage.*

*However, they could have considered in more depth whether an increase in the national minimum wage is key to an increase in employment.*

**Level 5** **22 marks**

## Examiner's summary comments

**Level 5 (21–25 marks)**

**Good** knowledge and understanding of the minimum wage and employment.

**Strong** analysis of the link between an increase in the national minimum wage and employment. A relevant and accurately drawn and labelled diagram is provided and linked to the analysis.

**Strong** evaluation including a supported judgement on whether an increase in the national minimum wage is the key to increasing UK employment.

There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.

# QUESTION 2

**The national minimum wage is set to increase by 20p to £6.70 in 2015 and more firms are introducing the living wage each year. The expectation is that this will result in greater employment and labour market participation.**

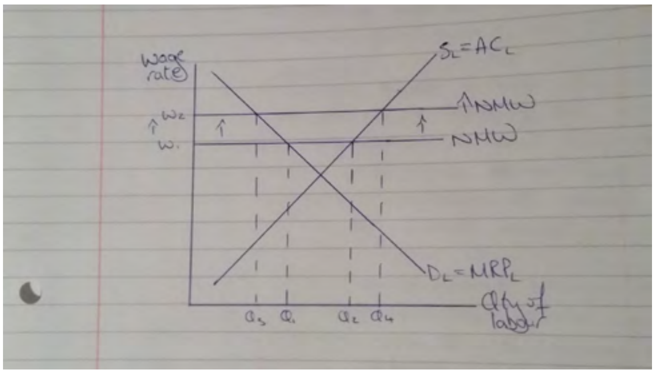
**Evaluate, with the aid of a diagram, whether, the increase in national minimum wage is the key to increasing UK employment. [25 marks]**

# CANDIDATE RESPONSE

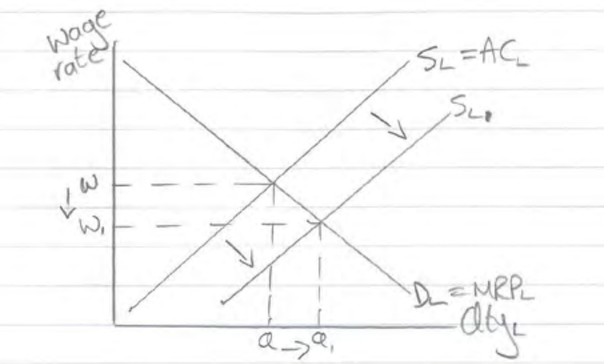
## Candidate B – UNANNOTATED

The National Minimum Wage sets the minimum hourly wage that is acceptable by law and must be paid by all firms. The aim of a National Minimum Wage is to reduce relative poverty associated with income and also to increase the incentive to work, resulting in increased employment within a country, and hence an improvement on one of the macroeconomic objectives. The current National Minimum Wage is £6.50 per hour.

The diagram below illustrates the increase in the pay floor as the national minimum wage increases. There is an extension of the supply curve but also a contraction of the demand curve resulting in greater excess supply of labour.




Firstly, increasing the National Minimum Wage will increase the supply of Labour in the market. This is because a guaranteed wage for employees will create a greater incentive to work. Hence there will be a greater participation rate and the supply of labour will shift to the right as shown in the diagram below. If there are job vacancies then this will result in increased employment. An increase in the National Minimum Wage will also reduce the employment trap as average wages will appear more attractive to workers than job seekers allowance. Furthermore due to the substitution effect an increase in the National Minimum Wage will result in workers substituting leisure time for work time and hence there will be an increase in hours worked and also average incomes.




However the effect on employment will depend upon a variety of things. Firstly, if the labour market does not have the required skills for the jobs then there will be not be an increase in employment; hence for a increase in the National Minimum Wage to benefit employment the labour market must be skilled and this can be achieved through supply side policies implemented by the government to increase education and training and hence reduce structural unemployment. Secondly, an increase in the supply of labour will ultimately reduce the long term real wage rate as the supply of labour shifts to the right.

# Candidate B – UNANNOTATED (Cont)

Secondly, an increase in the National Minimum Wage will reduce the demand for labour as it increases costs to firms. Depending on the elasticity of demand of the product being sold this may be passed on to the consumer if the product has inelastic demand however if it is elastic then it will result in the firm having to absorb the costs and hence reduce their demand for labour. A decrease in the demand for labour will result in a reduction in the number of jobs available as fewer firms will be looking to employ. This can result in reduced employment as there is high cyclical unemployment and combined with the effects of hysteresis individuals will find it difficult to find employment, this can result in high pressures on the public spending into JSA and hence an increase in the budget deficit. However the reduction in demand for labour will depend upon the demand for output seeing as demand for labour is derived demand. If the increase in the National Minimum Wage is accompanied by an increase in demand within the economy then demand for labour will not decrease as much, as firms will have increased revenues to cover increased costs. Demand for labour will also depend upon capital substitutes; if there is a sufficient capital alternative to replace higher labour costs then demand for labour may decrease even more than expected.

In conclusion, I believe that the increase in the National Minimum Wage will be important by not necessarily key to an increase in employment through changes in the supply and demand of labour as a consequence. It will benefit employment through an increase in the supply of labour; however this will depend upon a variety of things including jobs available. The increase in the NMW will also have negative effects on employment due to reduced demand for labour. Hence it can be very beneficial to employment within an economy, however whether it is key or not perhaps depends upon the state of the economy with regards to demand and the effects it will have on costs to firms within the market.

# QUESTION 2

**The national minimum wage is set to increase by 20p to £6.70 in 2015 and more firms are introducing the living wage each year. The expectation is that this will result in greater employment and labour market participation.**

**Evaluate, with the aid of a diagram, whether, the increase in national minimum wage is the key to increasing UK employment. [25 marks]**

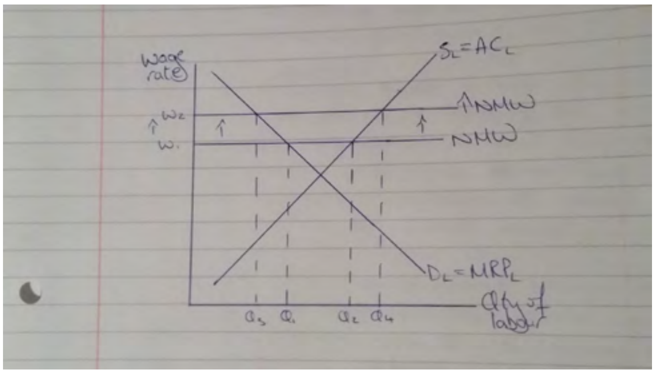
# CANDIDATE RESPONSE

# CANDIDATE B – ANNOTATED

The National Minimum Wage sets the minimum hourly wage that is acceptable by law and must be paid by all firms. The aim of a National Minimum Wage is to reduce relative poverty associated with income and also to increase the incentive to work, resulting in increased employment within a country, and hence an improvement on one of the macroeconomic objectives. The current National Minimum Wage is £6.50 per hour.

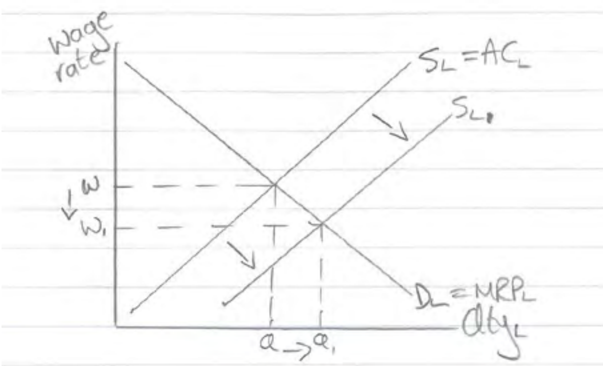
*Knowledge of the national minimum wage.*

The diagram below illustrates the increase in the pay floor as the national minimum wage increases. There is an extension of the supply curve but also a contraction of the demand curve resulting in greater excess supply of labour.




Firstly, increasing the National Minimum Wage will increase the supply of Labour in the market. This is because a guaranteed wage for employees will create a greater incentive to work. Hence there will be a greater participation rate and the supply of labour will shift to the right as shown in the diagram below. If there are job vacancies then this will result in increased employment. An increase in the National Minimum Wage will also reduce the employment trap as average wages will appear more attractive to workers than job seekers allowance. Furthermore due to the substitution effect an increase in the National Minimum Wage will result in workers substituting leisure time for work time and hence there will be an increase in hours worked and also average incomes.

*Analysis of the effects of an increase in the national minimum wage.*



## Candidate B – ANNOTATED (Cont)

However the effect on employment will depend upon a variety of things. Firstly, if the labour market does not have the required skills for the jobs then there will be not be an increase in employment; hence for a increase in the National Minimum Wage to benefit employment the labour market must be skilled and this can be achieved through supply side policies implemented by the government to increase education and training and hence reduce structural unemployment. Secondly, an increase in the supply of labour will ultimately reduce the long term real wage rate as the supply of labour shifts to the right.

*Evaluation of what the government need to provide alongside an increase in the national minimum wage to make the impact on employment more sustainable. Therefore a recognition that perhaps an increase In NMW isn't key.*

Secondly, an increase in the National Minimum Wage will reduce the demand for labour as it increases costs to firms. Depending on the elasticity of demand of the product being sold this may be passed on to the consumer if the product has inelastic demand however if it is elastic then it will result in the firm having to absorb the costs and hence reduce their demand for labour. A decrease in the demand for labour will result in a reduction in the number of jobs available as fewer firms will be looking to employ. This can result in reduced employment as there is high cyclical unemployment and combined with the effects of hysteresis individuals will find it difficult to find employment, this can result in high pressures on the public spending into JSA and hence an increase in the budget deficit. However the reduction in demand for labour will depend upon the demand for output seeing as demand for labour is derived demand. If the increase in the National Minimum Wage is accompanied by an increase in demand within the economy then demand for labour will not decrease as much, as firms will have increased revenues to cover increased costs. Demand for labour will also depend upon capital substitutes; if there is a sufficient capital alternative to replace higher labour costs then demand for labour may decrease even more than expected.

*Good further analysis and evaluation of whether there is demand for labour and so an increase in employment or just an increase in labour market participation and the number of people who are economically active.*

In conclusion, I believe that the increase in the National Minimum Wage will be important by not necessarily key to an increase in employment through changes in the supply and demand of labour as a consequence. It will benefit employment through an increase in the supply of labour; however this will depend upon a variety of things including jobs available. The increase in the NMW will also have negative effects on employment due to reduced demand for labour. Hence it can be very beneficial to employment within an economy, however whether it is key or not perhaps depends upon the state of the economy with regards to demand and the effects it will have on costs to firms within the market.

*A good evaluation which does consider whether an increase in the NMW is key to increasing employment. There is some supported judgement.*

**Level 5** **21 marks**

## Examiner's summary comments

**Level 5 (21–25 marks)**

**Good** knowledge and understanding of the minimum wage and employment.

**Strong** analysis of the link between an increase in the national minimum wage and employment. A relevant and accurately drawn and labelled diagram is provided and linked to the analysis.

**Strong** evaluation including a supported judgement on whether an increase in the national minimum wage is the key to increasing UK employment.

There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.

# QUESTION 2

**The national minimum wage is set to increase by 20p to £6.70 in 2015 and more firms are introducing the living wage each year. The expectation is that this will result in greater employment and labour market participation.**

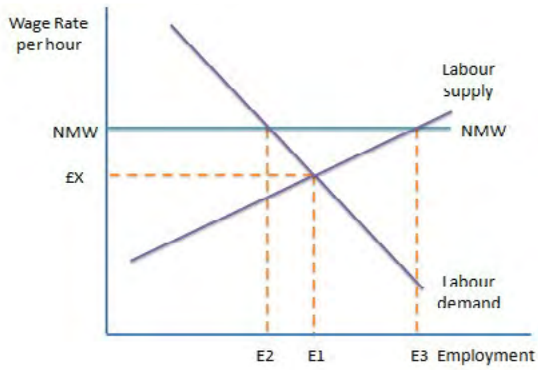
**Evaluate, with the aid of a diagram, whether, the increase in national minimum wage is the key to increasing UK employment. [25 marks]**

# CANDIDATE RESPONSE

## Candidate C – UNANNOTED

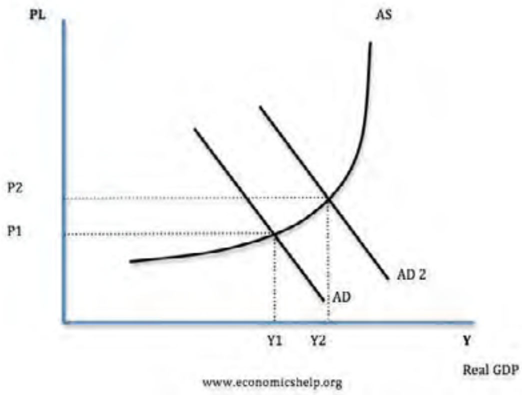
Unemployment may decrease due to an increase in the national minimum way. Unemployment occurs when a person who is actively searching for employment is unable to find work. The National Minimum Wage is the minimum pay per hour almost all workers are entitled to by law. This decrease in unemployment is because due to an increase in wages it gives people more incentive to find work. This would therefor mean that there was an increase in the supply of labour.

We can see this increase in the supple for labour in the diagram below. Due to an increase in national minimum wage the supple of labour has increase from E1 to E3. Although due to an increase in national minimum wage we are now seeing that the demand for labour and the supply for labour are in in equilibrium with one another. This is because firms will have increased costs, so there demand for labour has decreased.




Due to the increased incentive for people to find employment, providing there are jobs available for them, then unemployment will decrease. Therefore there will be less people claiming benefits, and JSA. This will therefore decrease the amount that the government has to spend on the unemployed. They can then spend the money on other things, such as education and apprenticeship schemes. This would therefore, hopefully, decrease unemployment further as people will have more skills, and therefore be more employable.

Due to an increase in wage rates, it will increase the amount of disposable income consumers have. This will therefore lead to an increase in consumption, leading to an increase in aggregate demand (a shift to the right as shown on the diagram below). This will lead to an increase in GDP (a shift from Y1 to Y2), and an increase in price level (a shift from P1 to P2).




Due to an increase in aggregate demand it will give people confidence, as well as that GDP in increase. This increase in confidence may see firms looking to invest, ar occurring and they will invest. This may therefor lead to an increase in the demand further as when firms are expanding, due to investment, they will need more work leads to further investment). This increase in investment, due to increased consum in aggregate demand further.

A limitation of increase minimum wage may be that due to an increase in wage rates firms will have increased costs. If a firm is running very tight margins, a slight increase in its costs may mean that they can no longer afford some workers. This may therefor mean that they lay people off. This is the opposite of the arguments mentioned before, as it will increase unemployment.

Another limitation is that due to an increase in minimum wage it may lead to increased prices. This will therefore decrease consumer welfare. This is because of an increase in costs to firms, firms have to increase their prices to compensate. Due to this increase in price it will cause the cost of living to increase also, which would then cause there to be the need to increase minimum wage further.

# Candidate C – UNANNOTED (Cont)

To conclude, I do think that increasing the national minimum wage will help to increase employment, but it is not the only things that can help, and many other thinks have to be taken into account. The change in employment will only be relative to the change in national minimum wage. The proposed increase in national minimum wage is only just over 3%, maybe for the government to be able to see a good decrease in unemployment there needs to be a larger increase in national minimum wage.

I do think that the increase in national minimum wage does increase costs of labour which makes it more expensive to employee people, therefore meaning that the increase in minimum wage would have the opposite affect- to decrease employment.

There are also many other ways of decrease unemployment, such as lowering taxes for business, as well as for workers. This would put less pressure on firms as they would have more money that could then be reinvested, and hopefully create more jobs. This is the opposite of increasing national minimum wage as it would increase firms' costs.

# QUESTION 2

**The national minimum wage is set to increase by 20p to £6.70 in 2015 and more firms are introducing the living wage each year. The expectation is that this will result in greater employment and labour market participation.**

**Evaluate, with the aid of a diagram, whether, the increase in national minimum wage is the key to increasing UK employment. [25 marks]**

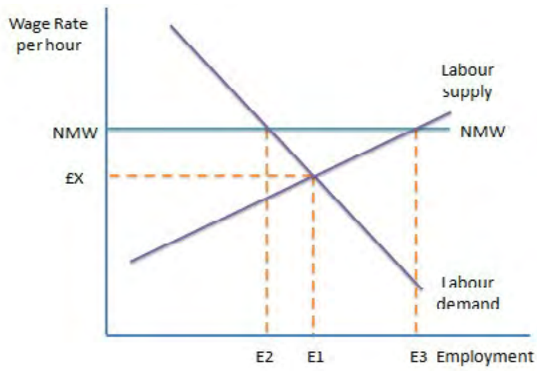
## CANDIDATE RESPONSE

## Candidate C – ANNOTATED

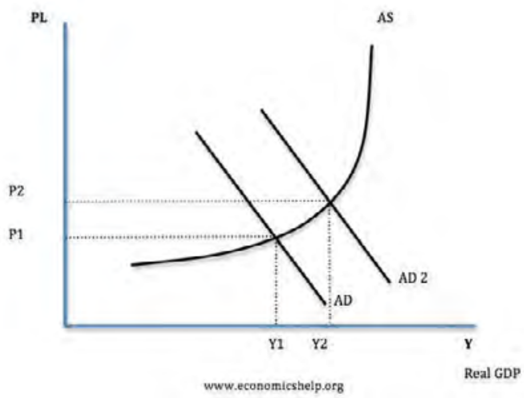
Unemployment may decrease due to an increase in the national minimum way. Unemployment occurs when a person who is actively searching for employment is unable to find work. The National Minimum Wage is the minimum pay per hour almost all workers are entitled to by law. This decrease in unemployment is because due to an increase in wages it gives people more incentive to find work. This would therefor mean that there was an increase in the supply of labour.

*The candidate sounds a little muddled because they start referring to unemployment rather than employment but they do understand the impact the NMW may have.*

We can see this increase in the supple for labour in the diagram below. Due to an increase in national minimum wage the supple of labour has increase from E1 to E3. Although due to an increase in national minimum wage we are now seeing that the demand for labour and the supply for labour are in in equilibrium with one another. This is because firms will have increased costs, so there demand for labour has decreased.




Due to the increased incentive for people to find employment, providing there are jobs available for them, then unemployment will decrease. Therefore there will be less people claiming benefits, and JSA. This will therefore decrease the amount that the government has to spend on the unemployed. They can then spend the money on other things, such as education and apprenticeship schemes. This would therefore, hopefully, decrease unemployment further as people will have more skills, and therefore be more employable.




Due to an increase in wage rates, it will increase the amount of disposable income consumers have. This will therefore lead to an increase in consumption, leading to an increase in aggregate demand (a shift to the right as shown on the diagram below). This will lead to an increase in GDP (a shift from Y1 to Y2), and an increase in price level (a shift from P1 to P2).

# Candidate C – ANNOTATED (Cont)

Due to an increase in aggregate demand it will give people confidence, as well as giving firms confidence to invest as they can see that GDP in increase. This increase in confidence may see firms looking to invest, and expand. Other firms will then see investment occurring and they will invest. This may therefor lead to an increase in the demand for labour, therefore decreasing unemployment further as when firms are expanding, due to investment, they will need more workers. This is called the accelerator affect (investment leads to further investment). This increase in investment, due to increased consumer and investor confidence, will lead to an increase in aggregate demand further.

*Good analysis of the reasons why NMW may increase employment.*

A limitation of increase minimum wage may be that due to an increase in wage rates firms will have increased costs. If a firm is running very tight margins, a slight increase in its costs may mean that they can no longer afford some workers. This may therefor mean that they lay people off. This is the opposite of the arguments mentioned before, as it will increase unemployment.

Another limitation is that due to an increase in minimum wage it may lead to increased prices. This will therefore decrease consumer welfare. This is because of an increase in costs to firms, firms have to increase their prices to compensate. Due to this increase in price it will cause the cost of living to increase also, which would then cause there to be the need to increase minimum wage further.

*Two good pieces of analysis of how employment may fall and unemployment may rise.*

To conclude, I do think that increasing the national minimum wage will help to increase employment, but it is not the only things that can help, and many other thinks have to be taken into account. The change in employment will only be relative to the change in national minimum wage. The proposed increase in national minimum wage is only just over 3%, maybe for the government to be able to see a good decrease in unemployment there needs to be a larger increase in national minimum wage.

*Good evaluation to draw the argument to a conclusion. The candidate does recognize that the question asks whether a higher NMW is key.*

I do think that the increase in national minimum wage does increase costs of labour which makes it more expensive to employee people, therefore meaning that the increase in minimum wage would have the opposite affect- to decrease employment.

There are also many other ways of decrease unemployment, such as lowering taxes for business, as well as for workers. This would put less pressure on firms as they would have more money that could then be reinvested, and hopefully create more jobs. This is the opposite of increasing national minimum wage as it would increase firms' costs.

*Alternatives are given and compared to an increase in NMW – this is good evaluation at the end of the essay. It would have been preferable to have also seen evaluation throughout.*

**Level 4** **16 marks**

## Examiner's summary comments

**Level 4 (16–20 marks)**

**Good** knowledge and understanding of the national minimum wage and employment.

**Strong** analysis of the link between increasing the national minimum wage and increasing UK employment levels.

A relevant and accurately drawn and labelled diagram is provided and linked to the analysis.

**Good** evaluation on whether increasing the national minimum wage is key to increasing UK employment but without considering whether it is the key.

There is a well-developed line of reasoning which is clear and logically structured. The information presented is relevant and in the most part substantiated.

# QUESTION 3

**A view held by some economists, is that profit maximisation is no longer relevant and that firms are seeking to me more socially responsible in their behaviour**

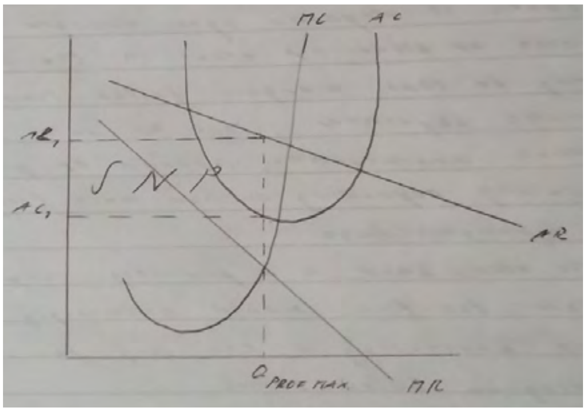
**Evaluate whether profit maximisation is still a realistic economic objective for firms. [25 marks]**

## CANDIDATE RESPONSE

## Candidate A – UNANNOTED

There are several economic objectives, such as profit maximisation, sales maximisation or corporate social responsibility (CSR). Profit maximisation is when marginal costs are equal to marginal revenue and the firm produces at that output. CSR is a quantitative objective and means that the firm looks after its stakeholders, i.e. in the form of fair prices to workers and suppliers.

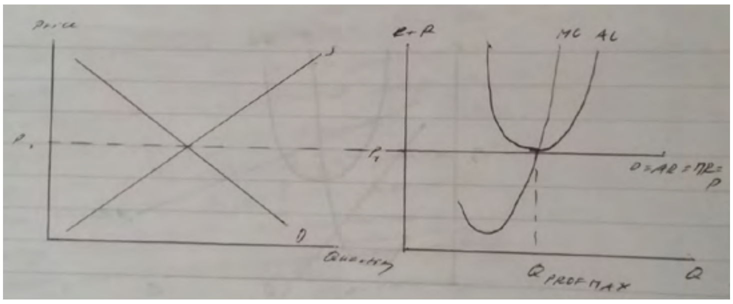
For monopolistic firms the main objective is usually profit maximisation in order to make supernormal profit (SNP) as shown on the diagram to the right:




If the monopoly sets profit maximisation as their main objective, they will be making SNP (where AR>AC), as the diagram shows. This would be important for the monopolistic firm because it can be dynamically efficient. This would lead to an increase in the firm's non-price competitiveness which would lead to an increase in the entry barriers in the market which would be beneficial for the firm as the threat of competition would be reduced making the market less contestable.

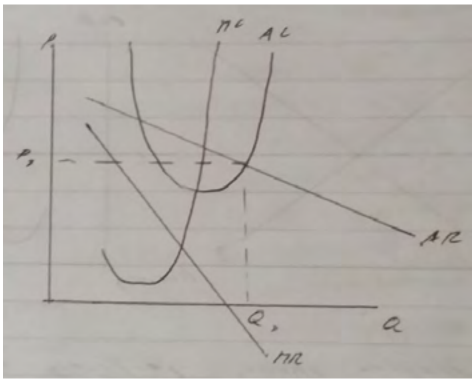
However, whether profit maximisation is realistic for the firm depends on whether the firm is regulated and therefore has to be allocatively efficient and whether the firm knows the exact output where they are profit maximising. It may be that the firm has to satisfice instead which means that it settles for an amount that is not profit maximisation but is sufficient to satisfy shareholders. However, it depends on whether divorce of ownership occurs in the firm. It may be that managers follow their own hubristic objectives, such as sales revenue maximisation, instead of profit maximisation depending on how much freedom the managers have.

On the other hand, in a perfectly competitive markets, the firm would necessarily be profit maximising in the long run as the diagram below to the right:




As the diagram shows, perfectly competitive firms would in the long run be profit maximising because if they produced at any other output they would not even make normal profit and therefore would not be able to stay in the market. Therefore profit maximisation is a realistic objective for firms, however, this must be evaluated in the context that perfectly competitive firms are not realistic in the real world and do not occur.

It can be argued that other objectives, such as sales maximisation or sales revenue maximisation, are more realistic for firms. Sales maximisation is when marginal revenue is equal to zero. This could be department specific and could relate to managerial utility maximisation. Sales maximisation is when average costs are equal to average revenue so that the firm makes normal profit. This is shown in the diagram to the right:




These objectives could be used by firms that want to increase in size and therefore increase sales and increase their reputation and loyalty and increase the barriers to entry by increasing their price competitiveness.

However, it can be argued that these objectives are short run objectives in order to achieve the objective of profit maximisation in the long run. It can therefore be argued that profit maximisation is not a realistic objective in the long run for smaller firms but it becomes realistic one entry barriers are high enough to limit the threat of competition. However, to evaluate this, nowadays there is increased competition in countries because of globalisation and technology so that it is unrealistic for firms to be able to increase entry barriers enough to limit competition and therefore profit maximisation.

# Candidate A – UNANNOTATED (Cont)

Moreover, it can be argued that the corporate social responsibility has become a more realistic objective. This means that the firm looks after the stakeholders, such as fair prices to workers and suppliers are being environmentally friendly. This is increasingly important because it enhances the reputation of the firm which could increase sales. However, as previously it can be argued, that CSR is a short run objective to achieved profit maximisation in the long run. A firm would use CSR to increase its non-price competitiveness and win customers. However, whether this is an objective depends upon if the consumer have choice, i.e. whether the market is monopolistic, because if the consumers do not have choice, there is no need for the firm to use CSR. It also depends whether the firm has the financial ability to spend money on CSR.

Overall, whether profit maximisation is a realistic objective for firms depends on the size of the firm and the market that they are in. It can also be argued that profit maximisation is only a realistic objective in the long run if the firm pursues other short run objectives that decrease the level of competition and enhance reputation. It can also be argued that nowadays, CSR Is more important and that profit maximisation is only realistic for firms if they keep high reputation and loyalty for example, by CSR.

# QUESTION 3

**A view held by some economists, is that profit maximisation is no longer relevant and that firms are seeking to me more socially responsible in their behaviour**

**Evaluate whether profit maximisation is still a realistic economic objective for firms. [25 marks]**

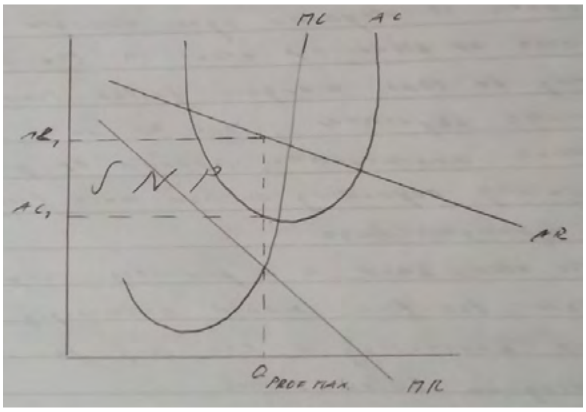
## CANDIDATE RESPONSE

## Candidate A – ANNOTATED

There are several economic objectives, such as profit maximisation, sales maximisation or corporate social responsibility (CSR). Profit maximisation is when marginal costs are equal to marginal revenue and the firm produces at that output. CSR is a quantitative objective and means that the firm looks after its stakeholders, i.e. in the form of fair prices to workers and suppliers.

*Good knowledge of the business objectives.*

For monopolistic firms the main objective is usually profit maximisation in order to make supernormal profit (SNP) as shown on the diagram to the right:



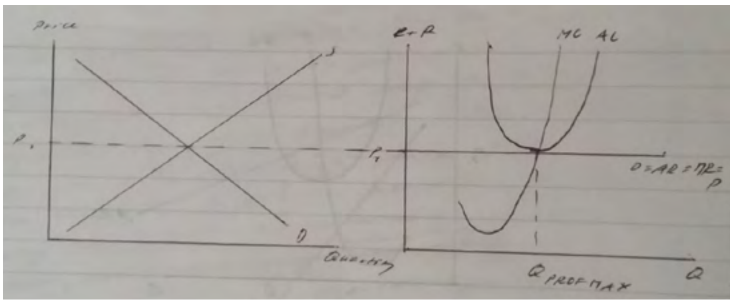

If the monopoly sets profit maximisation as their main objective, they will be making SNP (where AR>AC), as the diagram shows. This would be important for the monopolistic firm because it can be dynamically efficient. This would lead to an increase in the firm's non-price competitiveness which would lead to an increase in the entry barriers in the market which would be beneficial for the firm as the threat of competition would be reduced making the market less contestable.

*An appropriate diagram is used and the candidate understands the concept of profit maximisation and the behaviour of a monopolist. The diagram isn't fully labelled, but the others (below) are and so top level analysis is still accessible.*

However, whether profit maximisation is realistic for the firm depends on whether the firm is regulated and therefore has to be allocatively efficient and whether the firm knows the exact output where they are profit maximising. It may be that the firm has to satisfice instead which means that it settles for an amount that is not profit maximisation but is sufficient to satisfy shareholders. However, it depends on whether divorce of ownership occurs in the firm. It may be that managers follow their own hubristic objectives, such as sales revenue maximisation, instead of profit maximisation depending on how much freedom the managers have.

*Good evaluative point is explored here to illustrate a critique of the question.*

On the other hand, in a perfectly competitive markets, the firm would necessarily be profit maximising in the long run as the diagram below to the right:

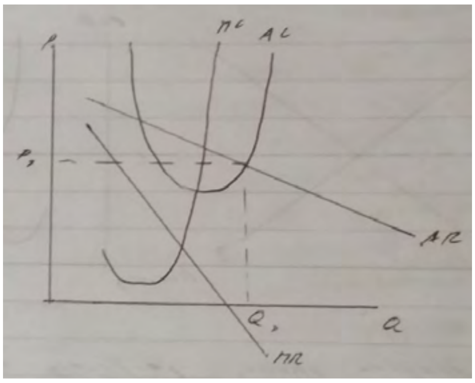



*Another appropriate diagram used and incorporated into the analysis.*

As the diagram shows, perfectly competitive firms would in the long run be profit maximising because if they produced at any other output they would not even make normal profit and therefore would not be able to stay in the market. Therefore profit maximisation is a realistic objective for firms, however, this must be evaluated in the context that perfectly competitive firms are not realistic in the real world and do not occur.

# Candidate A – (Cont)

It can be argued that other objectives, such as sales maximisation or sales revenue maximisation, are more realistic for firms. Sales maximisation is when marginal revenue is equal to zero. This could be department specific and could relate to managerial utility maximisation. Sales maximisation is when average costs are equal to average revenue so that the firm makes normal profit. This is shown in the diagram to the right:




*Good analysis of alternative objectives*

These objectives could be used by firms that want to increase in size and therefore increase sales and increase their reputation and loyalty and increase the barriers to entry by increasing their price competitiveness.

However, it can be argued that these objectives are short run objectives in order to achieve the objective of profit maximisation in the long run. It can therefore be argued that profit maximisation is not a realistic objective in the long run for smaller firms but it becomes realistic one entry barriers are high enough to limit the threat of competition. However, to evaluate this, nowadays there is increased competition in countries because of globalisation and technology so that it is unrealistic for firms to be able to increase entry barriers enough to limit competition and therefore profit maximisation.

*Strong evaluation of whether these objectives are realistic.*

Moreover, it can be argued that the corporate social responsibility has become a more realistic objective. This means that the firm looks after the stakeholders, such as fair prices to workers and suppliers are being environmentally friendly. This is increasingly important because it enhances the reputation of the firm which could increase sales.  However, as previously it can be argued, that CSR is a short run objective to achieved profit maximisation in the long run. A firm would use CSR to increase its non-price competitiveness and win customers. However, whether this is an objective depends upon if the consumer have choice, i.e. whether the market is monopolistic, because if the consumers do not have choice, there is no need for the firm to use CSR. It also depends whether the firm has the financial ability to spend money on CSR.

*Strong analysis and strong evaluation of the CSR objective.*

Overall, whether profit maximisation is a realistic objective for firms depends on the size of the firm and the market that they are in. It can also be argued that profit maximisation is only a realistic objective in the long run if the firm pursues other short run objectives that decrease the level of competition and enhance reputation. It can also be argued that nowadays, CSR Is more important and that profit maximisation is only realistic for firms if they keep high reputation and loyalty for example, by CSR.

*Strong evaluation with a supported judgement on whether profit maximisation is still a realistic objective. The candidate does so by considering what their judgement depends on.*

**Level 5** **25 marks**

## Examiner's summary comments

**Level 5 (21–25 marks)**

**Good** knowledge and understanding of economic objectives and the behaviour of firms.

**Strong** analysis of whether profit maximisation is still a realistic economic objective for firms.

**Strong** evaluation, including a supported judgement, of whether profit maximisation is still a realistic economic objective for firms.

There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.

# QUESTION 3

**Some economists believe that profit maximisation is no longer a relevant business objective and that firms are seeking to be more socially responsible in their behaviour.**

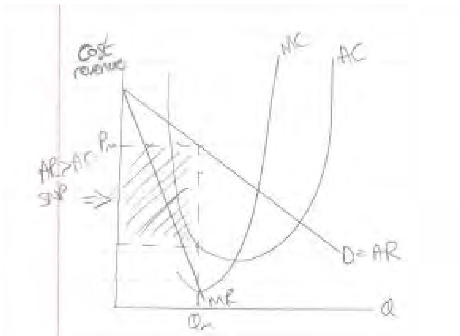
**Evaluate whether profit maximisation is still a realistic economic objective for firms. [25 marks]**

# CANDIDATE RESPONSE

## Candidate B – UNANNOTATED

Profit Maximisation occurs when marginal costs equal marginal revenues. In the long run, this will be the ultimate objective for the majority of firms, however in the short run, firms will aim to fulfil other objectives to profit maximise in the long run. The difference between the short run and the long run is that in the short run only the variable factor inputs can be changed where as in the long run both variable and fixed factor inputs can be changed.

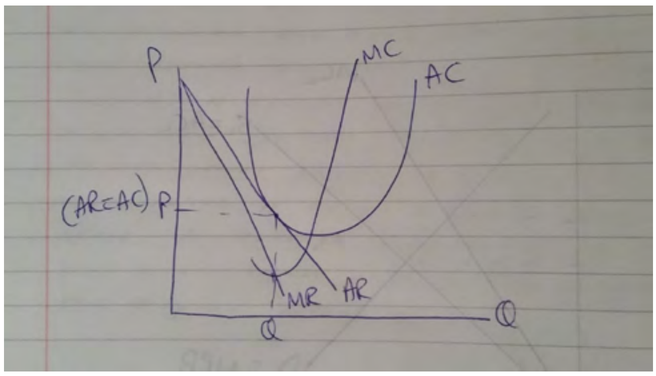
Firstly, the reason why profit maximisation will be the economic objective of the firm is because it will be the objective of the owner. Managers of firms will aim to satisfice the owners of the firm for job security purposes. Directors and owners will operate where MC=MR to achieve super normal profit (SNP) as shown in the diagram. This occurs when average revenues are greater than average costs. This will allow the firm to reinvest profit back into the firm into new innovative ideas. This will increase consumer surplus as it results in greater choice for consumers and through greater innovation into more efficient processes there will also be reduced prices in the long run through lower costs. However it is not guaranteed that a firm gaining SNP will achieve dynamic efficiency as the wrong decisions may be made, or the firm may decide to increase profit margins by retaining profit and not reinvesting.




There are many reasons why a firm will not achieve profit maximisation. Firstly, due to hubristic managers, objectives for the firm are set which are easily attainable and do not challenge the firm, this ensures the manager remains employed. This means that the firm can under achieve as managers are aiming to solely enhance their reputation. Secondly, as a firm expands there will be conflicting objectives of directors, managers and different departments. For example, sales managers may be rewarded through increased volumes of sales as they receive a commission and therefore have a incentive to sell more to the market, however the environmental manager may want to reduce quantity sold to the market to enhance the firm's Corporate Social Responsibility. This is an example of conflicting objectives and ultimately the divorce of ownership. However a method to combat this would be to give all employees a stake into the firm through shares as this will ensure all employees have a vested interest in the success of the firm. Thirdly, the final reason why a firm may not achieve profit maximisation is due to the difficulty for a firm to know where the profit maximising level of output is, and hence they may never reach the point where MC=MR.

Due to the reasons stated, profit maximisation may not still be a realistic objective. Therefore firms look for alternative objectives, one being Corporate Social Responsibility. Some firms may be more aware of the environmental impact of their firm and hence may decide to take action to use cleaner and more renewable resources and machinery. However this will result in large investments having to be made which could hinder the chances of a firm achieving SNP as average costs will rise, this will mean that assuming there are no short run benefits to revenue, short run SNP will fall or even not be achieved. However in the long run consumers may be more favourable to their products and consumers will feel more comfortable purchasing a product that has been environmentally friendly produced and hence long run revenues for the firm may increase. An example of this would be fair trade products where consumers are willing to pay a bit more for ethical reasons. This may create a more inelastic demand curve for the producers and hence allow them to cover the costs of these investments in a higher price and still have the opportunity to profit maximise in the long run.

Finally, as mentioned earlier different departments of the firm will have different objectives. Marketing departments will want to increase sales output to increase brand image and awareness of the firm. This will result in the in the firm operating at AC=AR as shown in the diagram. This is an example of conflicting objectives between departments.

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# CANDIDATE RESPONSE

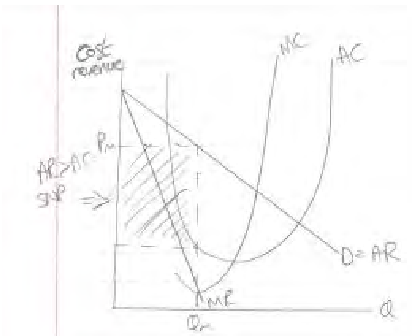
## Candidate B – ANNOTATED

Profit Maximisation occurs when marginal costs equal marginal revenues. In the long run, this will be the ultimate objective for the majority of firms, however in the short run, firms will aim to fulfil other objectives to profit maximise in the long run. The difference between the short run and the long run is that in the short run only the variable factor inputs can be changed where as in the long run both variable and fixed factor inputs can be changed.

*The candidate starts with good knowledge of profit maximisation.*

Firstly, the reason why profit maximisation will be the economic objective of the firm is because it will be the objective of the owner. Managers of firms will aim to satisfice the owners of the firm for job security purposes. Directors and owners will operate where MC=MR to achieve super normal profit (SNP) as shown in the diagram. This occurs when average revenues are greater than average costs. This will allow the firm to reinvest profit back into the firm into new innovative ideas. This will increase consumer surplus as it results in greater choice for consumers and through greater innovation into more efficient processes there will also be reduced prices in the long run through lower costs. However it is not guaranteed that a firm gaining SNP will achieve dynamic efficiency as the wrong decisions may be made, or the firm may decide to increase profit margins by retaining profit and not reinvesting.

*The candidate uses good analysis of the reasons for seeking to profit maximise and why it is still a realistic objective.*




There are many reasons why a firm will not achieve profit maximisation. Firstly, due to hubristic managers, objectives for the firm are set which are easily attainable and do not challenge the firm, this ensures the manager remains employed. This means that the firm can under achieve as managers are aiming to solely enhance their reputation. Secondly, as a firm expands there will be conflicting objectives of directors, managers and different departments. For example, sales managers may be rewarded through increased volumes of sales as they receive a commission and therefore have a incentive to sell more to the market, however the environmental manager may want to reduce quantity sold to the market to enhance the firm's Corporate Social Responsibility. This is an example of conflicting objectives and ultimately the divorce of ownership. However a method to combat this would be to give all employees a stake into the firm through shares as this will ensure all employees have a vested interest in the success of the firm. Thirdly, the final reason why a firm may not achieve profit maximisation is due to the difficulty for a firm to know where the profit maximising level of output is, and hence they may never reach the point where MC=MR.

*A concise but correct analysis of the alternative (perhaps more realistic) objectives of a business.*

*Analysis of why profit maximisation is not still realistic.*

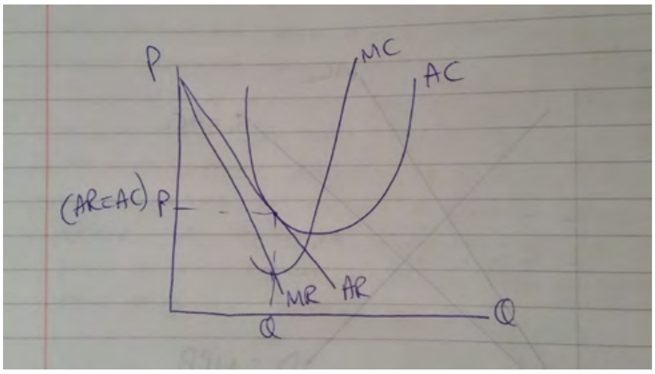
# Candidate B – ANNOTATED (Cont)

Due to the reasons stated, profit maximisation may not still be a realistic objective. Therefore firms look for alternative objectives, one being Corporate Social Responsibility. Some firms may be more aware of the environmental impact of their firm and hence may decide to take action to use cleaner and more renewable resources and machinery. However this will result in large investments having to be made which could hinder the chances of a firm achieving SNP as average costs will rise, this will mean that assuming there are no short run benefits to revenue, short run SNP will fall or even not be achieved. However in the long run consumers may be more favourable to their products and consumers will feel more comfortable purchasing a product that has been environmentally friendly produced and hence long run revenues for the firm may increase. An example of this would be fair trade products where consumers are willing to pay a bit more for ethical reasons. This may create a more inelastic demand curve for the producers and hence allow them to cover the costs of these investments in a higher price and still have the opportunity to profit maximise in the long run.

*The candidate has strong analysis of the question now – this paragraph on CSR really adds to the standard of the whole discussion.*

Finally, as mentioned earlier different departments of the firm will have different objectives. Marketing departments will want to increase sales output to increase brand image and awareness of the firm. This will result in the in the firm operating at AC=AR as shown in the diagram. This is an example of conflicting objectives between departments.

*Further development of the reason for why profit maximisation is no longer a realistic objective.*




In conclusion, I believe that profit maximisation is likely to be the primary long run incentive for a firm due to the financial rewards as a result. However due to the reasons I have mentioned which will restrict this objective such as conflicting objectives between departments, firms will look for alternative economic objectives, especially in the short run to ensure that they avoid the divorce of ownership and still have the chance to profit maximise in the long run.

*Strong evaluation by considering the short run and long run objectives of a firm.*

**Level 5** **23 marks**

## Examiner's summary comments

**Level 5 (21–25 marks)**

**Good** knowledge and understanding of economic objectives and the behaviour of firms.

**Strong** analysis of whether profit maximisation is still a realistic economic objective for firms.

**Strong** evaluation, including a supported judgement, of whether profit maximisation is still a realistic economic objective for firms.

There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.

# QUESTION 3

# CANDIDATE RESPONSE

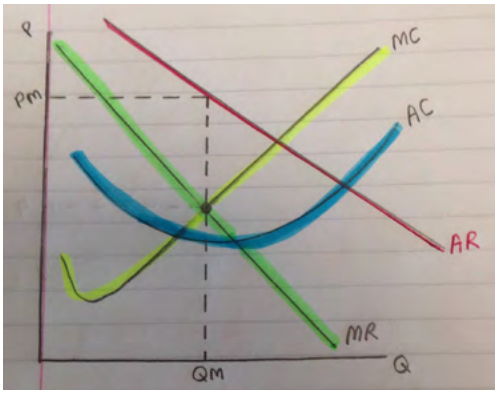
**A view held by some economists, is that profit maximisation is no longer relevant and that firms are seeking to me more socially responsible in their behaviour**

**Evaluate whether profit maximisation is still a realistic economic objective for firms. [25 marks]**

## Candidate C – UNANNOTATED

Profit maximisation is where marginal cost is equal to marginal revenue, and is the primary aim of a number of firms. However there are several other objectives, which have become a priority in firms due to variables such as the age of the firm. These include social or environmental concerns, growth maximisation, and sales maximisation.

Profit maximisation is a commonly prioritised aim due to the financial incentive, which drives a large number of firms. Profit maximisation opens up the potential for supernormal profits, incentivising many firms to make this their principal aim. As the diagram shows, supernormal profit is extra profit above the level of normal profit, occurring when average revenue exceeds average total costs. The monopolist will limit output (to Qm) in order to increase price to Pm and so average revenue will exceed average costs.




Supernormal profits can be reinvested into for example capital stock to increase the productive capacity of the firm, therefore increasing their Long Run Aggregate Supply. Supernormal profits can also enable a firm to reduce their prices, and consequently demand for the good or service will increase, aiding the growth of the firm.

However, as firms progress over time, this objective may take a back seat, due to other aims appearing more important. For example a richer firm may be able to prioritise environmental and social concerns, which could not be focused on previously due to a lack of finance to support this goal. More affluent firms may incur extra expenses in order to ensure their products are not tested on animals, or their products don't harm the environment, making them feel more socially responsible for their actions as they reduce negative externalities. Additionally they may feel incentivised to give back to society, and therefore will adopt charitable concerns as a priority. This may be due to moral reasons which can be taken into account after a certain level of growth and wealth have been reached, or contrastingly and controversially this could be used as a selling point for firms to further increase development of the firm. For example the Body Shop's selling point is the fact that their products are not tested on animals, and this results in increased demand due to consumer's environmental concerns. Increased demand (to a sufficient level) may mean that the firm can increase prices and therefore increase their revenue, but this is only if the environmental aspects have decreased the products price elasticity of demand. However this is usually an objective prioritised by more established firms as the financial cost may only result in a moral benefit, or they take the risk as using this objective as a selling point, but many new firms cannot afford to do so in the short run.

Arguably, growth maximisation may be a more realistic objective for firms to undertake, than profit maximising. Growth maximisation is an objective that may include mergers (the process of combing two companies in order to cut costs, and increase revenue, benefitting the shareholders of both of the original two businesses) and takeovers (where one firm acquires a controlling interest in another and consequently becomes the legal owner) in order to expand a firm. Therefore the firm may accept the loss of making marginal profit in the short term if it results in increased growth and power, then higher profits in the future. Growth maximisation is generally adopted as a priority by firms, which have the aim to become flourishing companies in the long term, but are willing to wait if that increases the benefits in the future. However this may depend on who manages the firm, if the owners are in charge of management they may be more financially orientated, whereas professional managers would want to maximise growth to ensure successful establishment in the market. Therefore more established firms might adopt this aim over profit maximisation, because they are capable of enduring this financial loss in the short run. Whereas a smaller and newer firm (perhaps in an infant industry) may not be able to incur these costs at the beginning, and therefore it is only for the older firms that this objective may overrule profit maximisation, much like the aim of environmental concerns.

Possibly, sales maximisation could be a more realistic objective for firms, as although much like growth maximisation it means less profit in the short run, the long term benefits of an increased market share would be worth it, that is if the firm can financially support this strategy. An increased market share increases a firm's monopoly power, subsequently the firm can raise prices because the product has become more price inelastic, and therefore enables increased profits in the future. Sales maximisation would

# Candidate C – UNANNOTATED (Cont)

achieve a substantial market share, potentially to monopoly level, as effective managers search for larger companies due to the high prestige and higher salaries, the prioritisation of this objective would result in a powerful management team in the long term, further increasing potential profits, perhaps to a supernormal level. However, arguably, smaller firms cannot adopt this objective as their main aim must be survival, and therefore the short term profits are essential if they want to continue manufacturing, and consequently sales maximisation is not always realistic, as it depends on factors such as the age of the firm.

There are numerous significant objectives a firm can adopt, and when determining how realistic they are, one must assess a variety of objectives such as the size and affluence of the firm, and the short term/ long term benefits. Arguably, profit maximisation is a relatively realistic objective, as a great number of firms have the sole incentive of profit in order to survive the market mechanism. However, more established firms with a larger market share can afford to sacrifice potential profits in the short run, in order to reap the benefits in the future, and subsequently this could be deemed as a more realistic objective for more advanced firms.

# QUESTION 3

# CANDIDATE RESPONSE

**A view held by some economists, is that profit maximisation is no longer relevant and that firms are seeking to me more socially responsible in their behaviour**

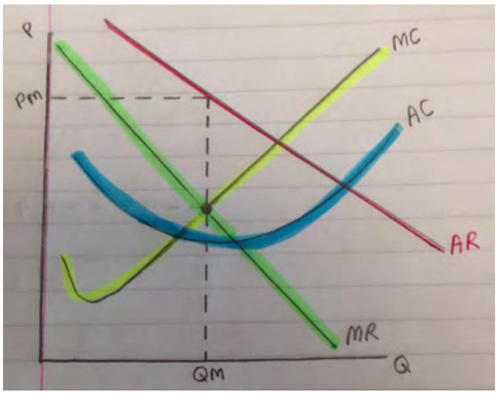
**Evaluate whether profit maximisation is still a realistic economic objective for firms. [25 marks]**

## Candidate C – ANNOTATED

Profit maximisation is where marginal cost is equal to marginal revenue, and is the primary aim of a number of firms. However there are several other objectives, which have become a priority in firms due to variables such as the age of the firm. These include social or environmental concerns, growth maximisation, and sales maximisation.

*Good knowledge of profit maximisation.*

Profit maximisation is a commonly prioritised aim due to the financial incentive, which drives a large number of firms. Profit maximisation opens up the potential for supernormal profits, incentivising many firms to make this their principal aim. As the diagram shows, supernormal profit is extra profit above the level of normal profit, occurring when average revenue exceeds average total costs. The monopolist will limit output (to Qm) in order to increase price to Pm and so average revenue will exceed average costs.




*Good knowledge of the behaviour of a firm seeking to profit maximise. The diagram is correctly labelled, accurate and is used in the analysis.*

Supernormal profits can be reinvested into for example capital stock to increase the productive capacity of the firm, therefore increasing their Long Run Aggregate Supply. Supernormal profits can also enable a firm to reduce their prices, and consequently demand for the good or service will increase, aiding the growth of the firm.

*Reasonable analysis of the reasons why profit maximisation is still a reasonable objective.*

However, as firms progress over time, this objective may take a back seat, due to other aims appearing more important. For example a richer firm may be able to prioritise environmental and social concerns, which could not be focused on previously due to a lack of finance to support this goal. More affluent firms may incur extra expenses in order to ensure their products are not tested on animals, or their products don't harm the environment, making them feel more socially responsible for their actions as they reduce negative externalities. Additionally they may feel incentivised to give back to society, and therefore will adopt charitable concerns as a priority. This may be due to moral reasons which can be taken into account after a certain level of growth and wealth have been reached, or contrastingly and controversially this could be used as a selling point for firms to further increase development of the firm. For example the Body Shop's selling point is the fact that their products are not tested on animals, and this results in increased demand due to consumer's environmental concerns. Increased demand (to a sufficient level) may mean that the firm can increase prices and therefore increase their revenue, but this is only if the environmental aspects have decreased the products price elasticity of demand. However this is usually an objective prioritised by more established firms as the financial cost may only result in a moral benefit, or they take the risk as using this objective as a selling point, but many new firms cannot afford to do so in the short run.

*Good analysis of an alternative objective and why profit maximisation isn't still a realistic objective.*

# Candidate C – ANNOTATED (Cont)

Arguably, growth maximisation may be a more realistic objective for firms to undertake, than profit maximising. Growth maximisation is an objective that may include mergers (the process of combing two companies in order to cut costs, and increase revenue, benefitting the shareholders of both of the original two businesses) and takeovers (where one firm acquires a controlling interest in another and consequently becomes the legal owner) in order to expand a firm. Therefore the firm may accept the loss of making marginal profit in the short term if it results in increased growth and power, then higher profits in the future. Growth maximisation is generally adopted as a priority by firms, which have the aim to become flourishing companies in the long term, but are willing to wait if that increases the benefits in the future. However this may depend on who manages the firm, if the owners are in charge of management they may be more financially orientated, whereas professional managers would want to maximise growth to ensure successful establishment in the market. Therefore more established firms might adopt this aim over profit maximisation, because they are capable of enduring this financial loss in the short run. Whereas a smaller and newer firm (perhaps in an infant industry) may not be able to incur these costs at the beginning, and therefore it is only for the older firms that this objective may overrule profit maximisation, much like the aim of environmental concerns.

*Again, further analysis of alternatives with some recognition of what choosing this objective depends upon – reasonable evaluation so far.*

Possibly, sales maximisation could be a more realistic objective for firms, as although much like growth maximisation it means less profit in the short run, the long term benefits of an increased market share would be worth it, that is if the firm can financially support this strategy. An increased market share increases a firm's monopoly power, subsequently the firm can raise prices because the product has become more price inelastic, and therefore enables increased profits in the future. Sales maximisation would achieve a substantial market share, potentially to monopoly level, as effective managers search for larger companies due to the high prestige and higher salaries, the prioritisation of this objective would result in a powerful management team in the long term, further increasing potential profits, perhaps to a supernormal level. However, arguably, smaller firms cannot adopt this objective as their main aim must be survival, and therefore the short term profits are essential if they want to continue manufacturing, and consequently sales maximisation is not always realistic, as it depends on factors such as the age of the firm.

*This next piece of analysis takes it to strong analysis and reasonable evaluation. There is again, some recognition of what adopting this objective depends on, i.e. the size of the firm.*

There are numerous significant objectives a firm can adopt, and when determining how realistic they are, one must assess a variety of objectives such as the size and affluence of the firm, and the short term/ long term benefits. Arguably, profit maximisation is a relatively realistic objective, as a great number of firms have the sole incentive of profit in order to survive the market mechanism. However, more established firms with a larger market share can afford to sacrifice potential profits in the short run, in order to reap the benefits in the future, and subsequently this could be deemed as a more realistic objective for more advanced firms.

*Good evaluation which does use the word 'still' but doesn't fully address this part of the question with a supported judgement.*

**Level 4** **18 marks**

## Examiner's summary comments

**Level 4 (16–20 marks)**

**Good** knowledge and understanding of economic objectives and the behaviour of firms.

**Strong** analysis of whether profit maximisation is still a realistic objective for firms.

**Good** evaluation of whether profit maximisation is still a realistic economic objective for firms without a supported judgement.

There is a well-developed line of reasoning which is clear and logically structured. The information presented is relevant and in the most part substantiated.

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