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Examiners' report

A LEVEL

ECONOMICS

OCR Level 3 Advanced GCE in Economics

H460

For first teaching in 2019

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Version 1

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Contents

Introduction

Our examiners' reports are produced to offer constructive feedback on candidates' performance in the examinations. They provide useful guidance for future candidates.

The reports will include a general commentary on candidates' performance, identify technical aspects examined in the questions and highlight good performance and where performance could be improved. A selection of candidate responses is also provided. The reports will also explain aspects which caused difficulty and why the difficulties arose, whether through a lack of knowledge, poor examination technique, or any other identifiable and explainable reason.

Where overall performance on a question/question part was considered good, with no particular areas to highlight, these questions have not been included in the report.

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Paper 1 series overview

It was pleasing to see that candidates found this paper accessible and managed their time effectively. Nearly all candidates answered the required number of questions and appeared to have enough time to showcase their knowledge and skills. Similarly, answers were usually structured clearly, with candidates trying to show depth of analysis rather than listing points. However, candidates should be reminded that a supported judgement is needed in 8- and 12-mark questions as well as the essays. This must not just repeat what has already been discussed and instead should suggest what the answer to the question depends on in the light of what has ready been discussed in their response. A cursory statement at the end of the answer is not enough to improve the response. As always, knowledge is gate keeper to effective analysis and evaluation, and candidates who scored well applied precise knowledge to their answers.

Candidates who did well on this paper generally:	Candidates who did less well on this paper generally:
• chose their essay wisely, ensuring that they could include and use a correct diagram for Questions 2 and 3 • addressed the main point of the question, showing a clear understanding of the economic concepts, it concerns • analysed and evaluated two points in their 25-mark essays, and one in the 8- and 12-mark questions, showing long chains of reasoning and depth of analysis • used the extract wisely to back up the economic concepts being discussed • used their own real examples in the 25-mark essays to contextualise their work.	• did not include economic concepts or theory • rephrased, rather than analytically used, the extract • included long descriptions of examples (e.g. Covid lockdown regulations) without reference to theory • showed an inconsistency of skills in their essays or only discussed one point • often displayed confused theory or used theory that was not relevant to the question • provided lots of relevant points instead of developing one or two.

Section A overview

The shorter questions in this section were mainly answered well and allowed candidates to ease into the paper. Candidates seemed to find the extract accessible, and it often helped them to understand what the questions were asking of them. Carefully reading the extract is a good use of time. However, less successful responses often rewrote far too much of the extract and did not take the concepts further, therefore only receiving application marks rather than analysis. For example, the extract states the 'consumption of plastic bottles creates an external cost', repeating this is not analysis or using theory as it has already been given to them. Candidates should recognise this and use these theory triggers in the extract to lead them to terms such as negative externalities of consumption and social costs being higher than private costs. Training candidates to recognise and develop these hooks in the extract would be a useful teaching strategy.

Question 1 (a) (i)

1
(a) Refer to **lines 7–11**.

(i) Using information from the stimulus material, explain the term **external costs**.

....

....

....

.... **[2]**

This question was well answered, with candidates making correct reference to the cost to the third party and using a relevant example from the extract. There was some confusion with social costs, with candidates incorrectly saying external costs were the cost to society.

Misconception: External Costs

?

Do not confuse social costs and external costs.

Social costs = private costs plus external costs.

Question 1 (a) (ii)

(ii) Using information from the stimulus material, explain the term **information failure**.

....

....

....

.... **[2]**

This question was well answered, with most candidates receiving full marks. Others should remember that the example they use will only be credited if it is from the extract.

Question 1 (b)

(b) Refer to **lines 15–19**.

Calculate the percentage change in branded water bottle consumption predicted by 2028.

....

....

....

.... **[2]**

This question was well answered.

Question 1 (c)

(c) 'Bottled water has seen a huge increase in its popularity in the last 50 years.' **Lines 1–2.**

Explain, using an appropriate diagram, the impact on the level of producer surplus of an increase in demand for bottled water.

....

....

.... **[4]**

Most candidates could answer this question well and identify the change in producer surplus. However, to gain full marks this needs to be fully explained. There are only 2/4 marks available for the diagram alone.

Question 1 (d)

(d) 'Both the market power and the environmental impact of the water industry have been a topic of much debate in the UK recently.' **Lines 20–21.**

Evaluate, using evidence from the stimulus material, whether there is market failure in the water industry.

....

....

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....

....

.... **[8]**

Candidates who performed well in this question followed a simple structure of why there is market failure, why there isn't market failure and then what the level of market failure depends on. Some responses used a diagram well, but full marks could be gained without it. There were many options for candidates to discuss e.g. Monopoly power, information failure, negative externalities. Better responses fully analysed one rather than discussing more points in less detail.

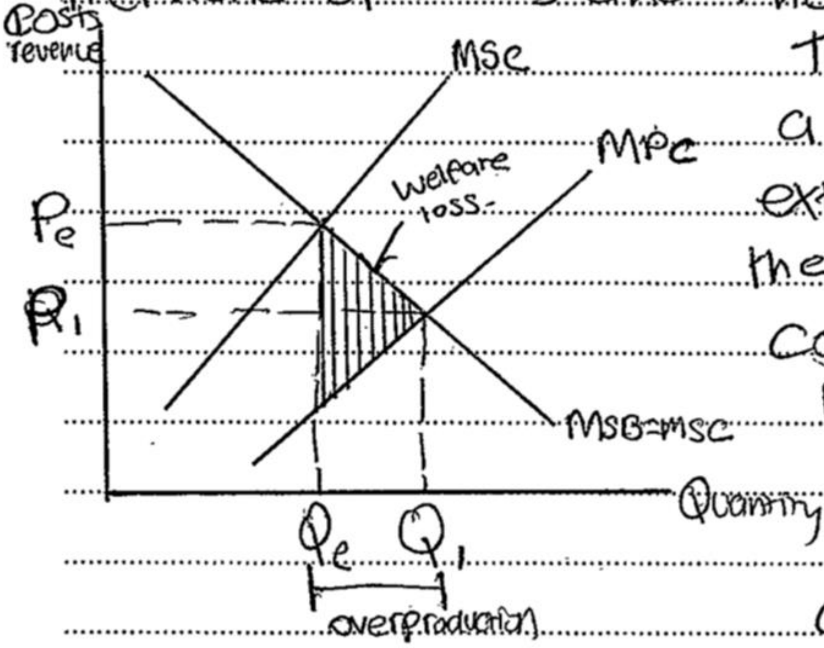
Assessment for learning: Well integrated diagrams

Quite a few candidates included a negative externalities diagram but incorrectly drew the diagram with the private costs greater than the social costs, showing a misunderstanding of the additional external costs.

Exemplar 1

Market failure is when the free market equilibrium does not match the socially optimal level of output.

There is market failure in the water industry in the form of a negative externality. There is a negative production externality from a 'release of untreated sewage into UK's network of rivers and the sea'.



This diagram represents a negative production externality as it shows the marginal social cost being higher than the marginal private cost which leads to an overproduction ~~of~~ which creates a negative externality leading to a welfare loss. Water industry are releasing sewage into rivers which have ~~negati~~ create negative externalities. Negative externality is a harmful effect on a third party. This includes sewage going into rivers and harming fish that live there. This could affect the food chain as humans rely on fish food food. [8]

extra paper ⟶

1b) So this sewage dumping could impact all humans as it will disrupt the food chain. Therefore this creates a negative production externality.

However there may not be market failure in ~~this~~ the water industry as despite there being externalities produced from them they have put in place measures to limit the impact and to help the environment for example increased renewable energy use, planting trees to restore original woodland and habitats and encouraging consumers to reduce water consumption. Therefore although there is negatives they have put in place measure to try and combat these to balance out the market. This paired with the regulatory body OFWAT can help to sustainably manage the water industry so market failure doesn't occur.

This candidate provides a clear negative externalities diagram and uses it illustrate overproduction and welfare loss. They use the extract to prove their point and include correct economic terminology. They continue with good evaluation but do not include a final supported judgement. Therefore, receiving 7/8 rather than full marks.

Question 1 (e)*

(e)* Two-thirds of England's biggest water companies employ key executives who previously worked at the water regulator OFWAT. **Lines 38–39**.

Evaluate, using evidence from the stimulus material, whether regulation of the water industry is beneficial to consumers. **[12]**

Many candidates did not link back to the end of the question which was whether regulation was 'beneficial to consumers'. Strong responses would, for example, explain how keeping prices for this price inelastic necessity would increase welfare and reduce inequality. Some used natural monopoly diagrams effectively, although this was not necessary to gain full marks. There was some confusion regarding regulatory capture, as some responses claimed that this was a benefit and did not understand that this would make regulation less effective. Others simply copied large amounts of text from the extract without linking it to theory.

Misconception: Utility

? Many candidates are confusing utility and welfare. If the price of water falls, this increases consumer surplus and thus welfare, but the utility stays the same. Utility can only be increased by increasing factors such as quality and choice.

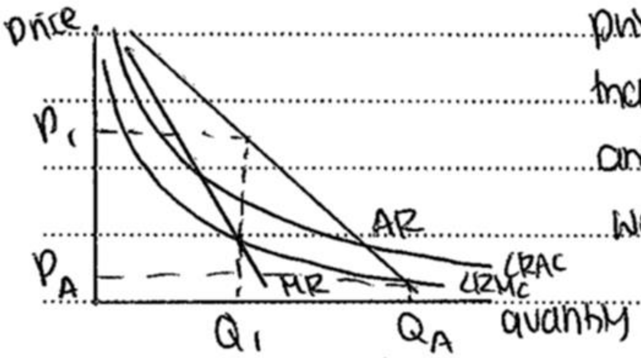
Exemplar 2

(e)* Two-thirds of England's biggest water companies employ key executives who previously worked at the water regulator OFWAT. **Lines 38–39.** regulatory capture

Evaluate, using evidence from the stimulus material, whether regulation of the water industry is beneficial to consumers. **[12]**

Regulation involves commanding economic agents' behaviour without directly affecting supply and demand. The water industry is an example of a natural monopoly, where the high fixed costs of infrastructure make competition almost impossible.

Firstly, regulation of the water industry would be beneficial to consumers ~~by~~ through it leading to lower prices and increased quantity. Significant market power and profit motive of these



private firms in the industry means that firms will choose to profit maximise and therefore the price of P_1 is way beyond the allocatively efficient point. OFWAT can regulate these firms to produce at the allocatively efficient point: $P_A Q_A$ at $LRMC = P$, making water more accessible and affordable, which is important as the good is a necessity.

However, regulating the industry to the allocatively efficient point means the firms would be making a loss and therefore the regulator must subsidise ~~to~~ the firm so they are making normal profit and don't have an incentive to leave the market. However, this leaves them with no supernormal profit to invest into ~~x~~ improvements in quality which could harm consumers. Furthermore, it could lead firms to cost cut in dangerous areas such as health and safety, water quality standards and environmental regulations, which would be undesirable for consumers. Additionally, the ~~regulation~~ subsidy comes at a cost for OFWAT and as a government business, it could come at an oppurtunity cost and take away funds from other services.

Furthermore, there could be a conflict of interest with regulators and firms, as the extract says key executives in the biggest water companies are employed after working at OFWAT. This regulatory capture means water regulaters may not work in the best interests of society and rather in self-interest to get a future job.

In conclusion, private firms ability to be efficient and innovative means that water has been left to the private market. However, regulation is definitely needed to reduce market power to prevent consumers being exploited. However, ways like introducing competition reduces the need for regulation and allows for market efficiencies to develop without cost. For example, OFCOM's need to regulate has been completely reduced through the seperation of vertical supply chains and competition.

Yes, AE point

No, OC and less SNR for quality

Yes, inequality

No, conflict of interest

Section B starts on the next page

This response has clear chains or reasoning that end on the point of the question – why consumers may or may not benefit from regulation.

Section B overview

Questions 2 and 3 demand the use of an appropriate diagram(s), but students should be encouraged to use as many appropriate diagrams as possible and if relevant include them in the other essays too. Well integrated diagrams aid analysis and help to reach higher levels of response on each of the skills descriptors. An incorrect diagram will stifle marks in these questions, so candidates should spend time checking their diagrams as there were often careless mistakes. For example, often there were missing labels or MC not bisecting AC at the lowest point, and this stopped responses reaching the highest levels of response. Candidates should be encouraged to use their own examples to contextualise their answers and aid application, but this should add to their theoretical knowledge, not replace it.

Question 2*

2* The term 'Pepsi price power' has been used to describe how the soft drink giant has been able to increase their revenue by raising price even against the backdrop of cost pressures caused by recent economic shocks worldwide.

Evaluate, using an appropriate diagram(s), the extent to which the principal agent problem is the main factor influencing the choice of objective for a firm. **[25]**

Although this was a popular choice of question, most candidates struggled with this question. There was often a good understanding of different objectives, most responses did not answer the question and lacked a true understanding of the principal agent problem. There was little acknowledgement of principal agent problem only really being relevant for public limited companies as it is only when there is a divorce of ownership and control that shareholders objectives become mismatched with managers and profit satisficing may occur. Good responses explained this clearly and discussed how managers may then pursue objectives in their self-interest and why these would benefit them. For example, revenue maximisation in order to receive higher bonuses. Counterarguments could then discuss how this is not an issue for different types of ownership or if managers bonuses are aligned with share issue schemes. There was a lack of understanding that smaller firms, e.g. those in monopolistic competition, have to profit maximise in the long run in order to make normal profits and thus reward their factors of production sufficiently, so cannot pursue alternative objectives.

Answer the question

This essay should have focused on which type of firms are influenced by the principal agent problem with setting objectives, not listing different objectives and the effect they have on a firm.

Exemplar 3

2* The term 'Pepsi price power' has been used to describe how the soft drink giant has been able to increase their revenue by raising price even against the backdrop of cost pressures caused by recent economic shocks worldwide.

Evaluate, using an appropriate diagram(s), the extent to which the principal agent problem is the main factor influencing the choice of objective for a firm. **[25]**

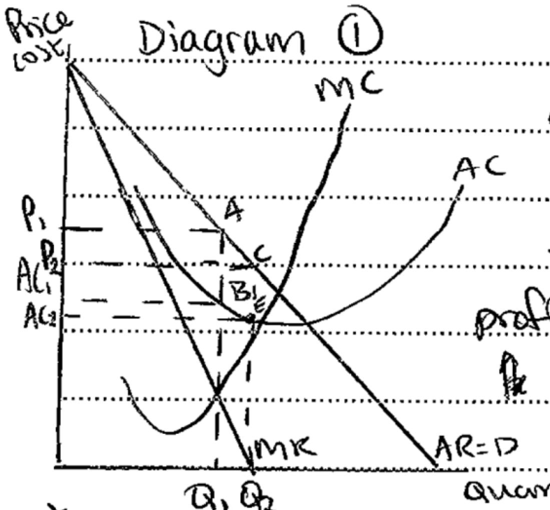
for against

define profit max

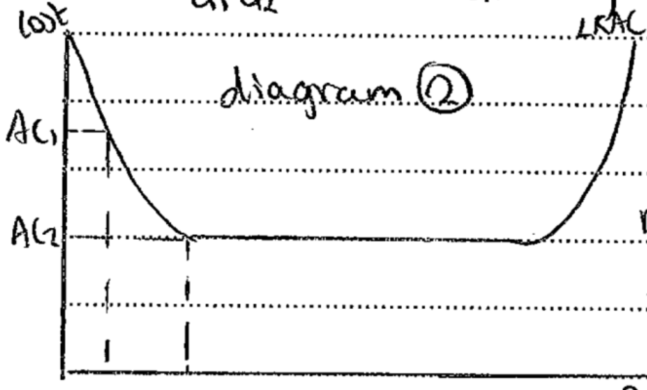
Question No. 2

The principle agent problem is when conflicts of interest ~~arise~~ arise from different economic agents having different goals. The principle agent problem can influence objectives as seniors in firms, such as stakeholders may wish to maximise profits, whereas managers, with sales specific bonus targets may want to maximise revenue or volume.

One reason in which the principle agent problem is the main factor for influencing a firms objective is ~~My~~ due to firms operating at profit maximisation. A ~~sk~~ senior executive or a shareholder is likely to have the goal to maximise profits which means operating at profit maximisation point A on diagram 1. This means the firm would make abnormal profits



equal to area P_1, A, B, AC_1. By operating at this point a firm can be dynamically efficient and reinvest these profits with the aim to growth more in the future, possibly benefitting from economies of scale in the long run. This is shown in the ~~shift of AC from AC1 to~~ movement along the LRAC curve from AC_1 to AC_2 on diagram ②, possibly due to factors such as hiring managers to increase and monitor output.



These managers may want to operate at revenue maximisation which occurs when MR=0 at point C selling at P_2 on diagram ①. This is because they are likely to have bonuses that are linked to revenue targets. The extract states that Pepsi raised revenue, likely by operating at revenue maximisation. This objective is likely as a firm's output is largely determind by the managers as they are the ones controlling their teams and the efficiency of the firms factors of production.

This section of this exemplar response clearly shows that the candidate understands the principal agent problem and how it affects objectives. This is strong analysis.

Question 3*

3* The price of oil rose to $79.90 per barrel in July 2023. Over the same period, food price inflation reached 13.4% in the UK.

Evaluate, using an appropriate diagram(s), the extent to which a rise in the price of oil will always lead to a rise in the price of goods and services sold in UK supermarkets. **[25]**

It was surprising that more candidates did not choose this question as there was an easy route to strong analysis by using simple demand and supply analysis and showing the effect of an increase in the cost of production on the price of food. This could then be evaluated using price elasticity of demand. Very few candidates, however, recognised that firms can only pass on all the increase in cost to the consumer when demand is perfectly inelastic. Exceptional answers also discussed oligopolies and sticky prices and some evaluated with collusion. There was lots of scope to use theory which was often missed.

Misconception: Complementary goods and derived demand

Some students were incorrectly referring to oil used in transportation and food as complementary goods. They are not bought together, the demand for transportation fuel is derived from the demand for the goods.

Section C overview

Candidates should be reminded that their essay choice should be based on the title they feel that they can discuss and evaluate two clear points with correct use of economic theory. Some of the questions this year could be answered in a 'non economist' way, but these answers without economic theory scored very low marks. For example, some candidates answered Question 5 in this way, recounting stories of Covid regulations and lockdown rather than applying their economic knowledge.

Question 4*

4* Supporters of the free market have long argued that supply and demand lead to the most effective allocation of society's scarce resources. However, those in favour of a more interventionist approach have cited the recent high prices of essentials such as gas, electricity and basic foodstuffs as a reason for greater government control in markets.

Evaluate the extent to which the free market is the most effective way to ensure an efficient allocation of resources. **[25]**

This question was often answered well, with candidates giving detailed explanations of how the price mechanism works and the signalling, incentivising and rationing function. The stem of the question helped candidates to recognise that market failure was an easy route to evaluation. However, some candidates incorrectly assumed that the free market would always have perfect competition, whereas the presence of monopolies is a disadvantage of the free market. Good supporting judgements recognised that it depends on the nature of the product and how it is produced as to whether the free market can allocate resources efficiently.

Misconception: Free Market and Market Structures

? All types of market structures exist in the free market. The free market does not necessarily provide competition.

Question 5*

5* During the COVID pandemic the UK government used information provision in various ways. These included advice on washing hands, the importance of vaccinations and lockdown rules for households and workspaces.

Evaluate the extent to which information provision is effective at incentivising consumers to change their behaviour. **[25]**

This question was rarely answered well and often lacked the use of economic theory. Strong responses understood that information provision enables consumers to fully understand the consequences of their actions on themselves and/or a third party so more accurately measure their utility. This can help to change the behaviour when consumers are purchasing merit and demerit goods. Some students used diagrams correctly to aid their analysis, showing demand with and without information. Useful evaluations included the lack of incentive to change when the benefit or cost is to a third party rather than the individual, or the inability to change due to habitual behaviour. There were some incorrect references to price elasticity of demand. The price of the product has not changed so this was not relevant unless the candidate was discussing alternative methods of changing behaviour. As this question was discussing the effectiveness of information provision to change behaviour, alternative methods such as regulation or taxation were relevant in evaluation, as long as they were compared to information provision.

Misconception: Merit/Demerit goods and those with externalities

A merit good is under consumed as the consumer underestimates the utility it brings to them. A good with a positive externality has a benefit to a third party. Some goods, for example education will be both.

A demerit good is over consumed as the consumer overestimates the utility it brings to them. A good with a negative externality has a cost to a third party. Some goods, for example cigarettes will be both.

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