Micro-Economics

Micro-Economics Essays start here

PL Discuss how the divorce of ownership from control may affect both the conduct and performance of firms. (25)

- Point 1: It may lead to the principal agent problem, where shareholders and managers have different objectives. This may cause instability within a firm, and prevent efficient running of it. If owners are pursuing sales max, it may lead to a firm's financial health deteriorating. It may also present a moral hazard, eg in investment banks, employees may take excessive risks knowing if they lose money, it would be the firms money not theirs.
- Eval: This would depend on how much accountability the owners retain. They could just remove the agent, like fire managers. Board members are often the owners, who could vote to remove CEO's etc. Moreover, it would also depend on the scale of the firm, as smaller firms don't really suffer from this problem, as the principal in most likely the agent. Eg owner is the employee
- Point 2: It may lead to inefficiency, as there could be communication gaps, conflicts, employees obstructing each other, therefore causing diseconomies of scale. Moreover, there may be a lack of a clear goal, as all agents are likely to work for maximising their own welfare, i.e. employees would look to increase wages, instead of maximising profits for the company.
- Eval: They may synchronise their objectives, eg if owners want to higher profits, they could like the bonuses of managers to higher profits, so both the principal and agent would be satisfied by one goal of higher profits. Also, bringing in experts like professional managers may actually improve efficiency, causing higher profits for the firm.

- Point 3: Owners may want to profit maximise for greater dividends but managers and senior staff members will want to sales/ revenue maximise to incentivise promotion and bigger bonuses - thus inefficiency will creep in as firms have communication issues between the two principal agents of firms causing for increased costs and profits if any will be eradicated
- Eval: depends on if firm has employed specialist managers to control the behaviour and conduct of these firms and provide the best of both worlds?

PL Assess the view that price discrimination is always damaging. (25)

- Point 1: It may lead to exploitation of consumers, as demand for products such as trains may be inelastic, and a higher price would lead to a loss of welfare, especially of lower income group consumers, and could price them out of the market.
- Eval: However one may argue that a firm uses excess profits from inelastic consumer groups to subsidise lower prices charged to consumers with elastic demand, therefore increasing welfare, and also increasing equality, as such low income consumers may previously have been unable to buy the product at a higher price. One may also argue that it is fair in a free market, higher demand for a product leads to higher prices, which leads to allocative efficiency.

workers due to lower commute times, but may also increase the size of the workforce, since workers that previously may be geographically immobile can now find jobs further away from where they live. Both if the above would lead to SRAS shifting to the right, causing economic growth, higher employment, and lower inflation. Also this would boost AD, since there is higher gov spending, leading to economic growth, but no rise in price levels due to LRAS shifting out as well, cancelling out any possible rise, leading to higher growth, but stable low inflation.

- Eval: In the short run, this may cause inflation. This would be as the gov spends on the project, but the project may take time to complete, leading to a rise in AD, but no rise in LRAS. If project is failed, as some parts of HS2 are, then it would only cause inflation and financial crowding out, and a rise in debt,. Such supply side policy may not fulfil the macro objective of sound gov finances.

Using the data and your economic knowledge, evaluate the view that mining activities should be left to market forces with minimum intervention by governments. (25 marks)

P1: In market forces = profit motive = efficient outcomes as productive efficiency and allocative efficiency meet in the economy. They have the incentive to reduce costs and achieve allocation of resources to consumer demand. Resources allocated efficiently. Supply meets demand so scarce resources are rationed and market failure is prevented
E1: Depends on monopoly power as it results in market failure. Monopoly power results in static-inefficiency as they are price-setters and price above equilibrium resulting in excess price and constrained quantity = market failure. 'Monopoly power often leads to significant market failure'
P2: Govt intervention required as free-market economy leads to firms not caring about the social costs of production. A form of intervention such as tradable pollution permits can help eradicate the activities of mining that result in costs on third parties. As a result, resources are allocated at the equilibrium through state intervention since they consider the social welfare
E2: Distortion in market economy which means that slice in profit for monopolies in mining industry so less funds for re-investment. Risk for government failure as the cost of intervention outweighs the benefit of it. For example, firms may leave the industry and this causes loss in terms of corporation tax, employment and potential for black market to creep in. Reduction in negative externality as they have control over scarce resources which puts burden on monopoly power which reduces it. Raising prices of rare earth materials more than it should which changes the value of the commodity (more than it should).
Monopoly = dynamic efficient they may use profits to reinvest and prevent market failure
PPP = best of both worlds (includes the merits)
Govt intervention is only effective if working with other countries
Many countries chose to avoid regulation even though it is necessary

Impact of changes in taxes on macroeconomic objectives (e.g. VAT, income tax, corporation tax) (25)

- Point 1:A fall in income tax may lead to higher economic growth. This is because workers will be incentivized to work more, since they can keep more of their income leading to a rise in productivity, therefore LRAS shifting out, causing economic growth, whilst lowering inflation.
- Eval: This would depend on the position of an economy on the keynesian lras. If in recession, then a rise in LRAS would not lead to economic growth, and also lower taxes would lead to a fall in gov revenue, therefore lowering gov spending, lowering AD, leading to a fall in economic growth.

- Point 2: Progressive taxation may lead to lower inequality, since the gov can tax the rich more, and the poor less. The extra revenue may be given as transfer payments / benefits, allowing for a more equitable dist of income, leading to lower levels on inequality.
- Eval: Highest tax for rich dosent necessarily mean higher gov revenue, laffer curve, tax evasion/ people leaving the country, brain drain, lower productivity, lras shifts in, so low economic growth, whilst no improvement in inequality.
- Point 3: Lower rate of corporation tax may mean firms face lower costs, so invest more so sras shifts right, leading to a fall in inflation and higher gdp, causing economic growth. Lower prices may also make exports more competitive, leading to a better BOP CA. It may also lead to a rise in FDI, causing higher ad, further leading to economic growth.
- Eval: If lower tax, gov revenue falls, so lower gov spending, preventing economic growth, and lower ad, possible lower transfer payments so higher inequality., exchange rates, ad rise neutralising right shift of sras, so imports may not actually be more competitive. Even if they were, it would be for the short term in a floating system, where currency demand would increase, pushing prices back up.
- Point 4:If indirect taxes (VAT and excise duty) are increased it is likely to reduce income equality. Excise duties tend to be regressive (people on low income pay a higher % of income). Inc inequality.
- Eval: Depends on elasticity of Good. Inelastic goods such as milk etc higher inequality but on elastic goods, effect isnt felt as much.
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Impact of changes in government spending on macroeconomic objectives (25)

- Point 1: Lower gov spending can cause inequality. Since transfer payments are low, poor will get poorer, and this combined with a regressive tax system may lead to worsened inequality. This may be damaging, especially considering today’s economic scenario of high levels of inflation causing a cost of living crisis. It may even cause LRAS left, since poverty trap, people don’t have good education etc, less productive, low economic growth
- Eval: In countries such as the UK, education etc is free, so chance of poverty trap occurring are v low. Instead revenue saved from transfer payments could be used for capex, causing a rise in long run growth LRAS right.
- Point 2: Lower gov spending may lead to lower transfer payments leading to rise in employment, since workers previously relying on benefits would now be incentivized to work, since they may not be earning as much. This would allow people to escape benefits trap and lead to a rise in workforce, leading to LRAS shifting out, causing economic growth, and higher levels of employment.
- Eval: However this may not occur as transfer payments being reduced would mean lower consumption by low income households, causing a fall in ad, causing a fall in derived demand for labour, so less jobs would be available, preventing such people from finding a job, leading to not only unemployment persisting, but now with higher levels of inequality, as these households would not be receiving as much income. Moreover, even if such people found jobs, it may cause inflation, as shown by the Philips curve, a lower unemployment causing higher inflation
- Point 3: High gov spending may cause economic growth both in the short and long run. This is as AD will increase i and in the long run, if gov spends on Capex, then LRAS will shift right, causing further economic growth.
- Eval: However the effects of gov spending leading to a rise in lras may only be felt in the long run, and in the short run the rise in ad is likely to cause inflation. Time lags would mean that the economy in the short run becomes uncompetitive, possibly

1.25 million people were unemployed in November 2022 – January 2023, a fall of 94,000 from the year before. The unemployment rate was 3.7%. The UK harmonised unemployment rate for Q3 2022 was 3.6%, above the rate of Germany (3.0%) and equal to the US (3.6%) but below that of France (7.2%).
Productivity across the whole UK economy increased by 0.3% in Q4 2022 compared with the previous quarter. Compared with the previous year, it was down by 0.1%.
Government borrowing in the financial year to January 2023 was £117 billion according to the ONS's latest provisional estimate, £7 billion more than in the same period last year. At the end of January 2023, public sector net debt was equivalent to 98.9% of GDP, compared to 97.7% a year before.
The UK had a trade deficit of £15.3 billion in the three months to January 2023, compared with a £4.5 billion deficit in the previous three months. The current account deficit was £19.4 billion in Q3 2022 (3.1% of GDP), down from £35.1 billion in Q2 2022 (5.7% of GDP).
The value of sterling fell by 0.6% between January and February, following a decrease of 1.0% between December and January. Compared with a year ago, it is 5.8% lower.
The volume of retail sales decreased by 0.9% in the three months to January 2023 compared with the previous three months, and decreased by 5.7% compared with the previous year.
GfK's Consumer Confidence Index, which measures consumer attitudes, was at -38 in February 2023, up by seven points from -45 in January.
House prices increased by 9.8% in the year to December 2022.

Household debt stood at 133.8% of disposable income in Q3 2022. It has been around this level since mid-2017.
Amazon spend 20-30 bn dollars on innovation- robotics in distribution
The Inflation Reduction Act (IRA) was signed into law by President Biden in August 2022. The Act aims to spur investment in green technology in the United States by devoting $369bn in subsidies through grants, loans and tax credits to public and private entities- also helps deal with cost of loans- more investment.

Is it a good idea for governments to prioritise inflation over deflation (25 markers)

Deflation can lead to a decrease in investment for several reasons:

1. Lower Profitability: In a deflationary environment, businesses may face falling prices for their products and services, which can lead to lower profitability. This can discourage businesses from investing in new equipment, hiring new workers, or expanding their operations, as they may not see a sufficient return on their investment.
2. Increased Uncertainty: Deflation can increase uncertainty in the economy, as businesses and investors may not know when prices will stop falling or when demand for goods and services will pick up. This uncertainty can make businesses hesitant to invest, as they may not want to take on the risk of investing in a market with decreasing prices.
3. Decreased Consumer Demand: As mentioned earlier, deflation can lead to a decrease in consumer demand for goods and services, as people delay purchases in anticipation of lower prices in the future. This can lead to lower revenues for businesses, reducing their ability to invest in new projects or expand their operations.