A-LEVEL
ECONOMICS

7136/1: Markets and Market Failure
Report on the Examination

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General

This was the third sitting of the Linear A Level Paper 1: Markets and Market Failure. The paper assesses mainly the subject content found in Section 4.1 of the specification 'Individuals, firms, markets, and market failure'. The economic principles included in Section 4.2 of the specification can also enrich their responses. In addition, the first bullet point in section 7.2 of the specification reminds students and centres about the quantitative skills that they should be competent in.

In Section A, Context 1, 'The market for sand', was less popular than Context 2, 'The British railway system', with around 35% of students choosing the first. In Section B, Essay 3, minimum price and the impact of elasticity and the national minimum wage, was the overwhelming favourite, chosen by almost 60% of students.

Context 1

Question 1

Students were required to calculate the percentage change in the price of construction sand between two points in time to one decimal place. Almost half of them earned 2 marks, but some chose the wrong type of sand, or their answers fell out of tolerance having read one or both figures inaccurately from the line graph. These responses earned no marks, however, if students showed the correct method they were awarded 1 mark. A mark was also available for a correct answer that was not rounded to 1 decimal place and/or did not include the % sign.

Question 2

For the 4 mark questions (questions 2 and 6) students needed to demonstrate that they understood how the data provided supported a particular proposition. They needed to provide evidence from the data, and then clearly explain how the data acts as evidence to support the proposition.

Students were required to explain how the data showed that expansion in the global sand market was leading to prices of construction rising in real terms. Whilst definitions are not essential they can help to support the explanations. Some students defined 'market mechanism', or aspects of it, to help explain the link between rising demand and price, and 'real', to help deal with 'real terms'. In addition to a definition or brief explanation, in the stronger answers, students said what they expected to find to address the question. They then quoted accurate evidence from the data and tied the answer up by saying how this evidence explained what had been asked for. The evidence quoted was usually good. Only a relatively small proportion of students went on to explain the rise in price in 'real terms'. Weaker responses tended to not recognise Figure 1 as a set of indices, read the data inaccurately from the graph or ignored the 'millions of tons' in Figure 2. The explanations of how the data provided evidence were often unclear or limited.

Question 3

In this question, students needed to use a diagram to help them explain how cheaper transportation and a construction boom in East Asia led to growth in the market for sand. It was expected that students would use a supply and demand diagram, showing a rightwards shift in both curves leading to higher levels of output. Occasionally, cost curve diagrams were used to represent the lower costs of transportation and these were acceptable if supported by a logical chain of reasoning.

Some students made good use of the clues in the data to put the changes in both transportation costs and the construction boom into context. These were then effectively linked to supply and demand and the growth of the market. With the help of a diagram these students developed their responses using well-focused, logical analysis and achieved high marks. Some students dealt better with one change than the other. For example they acknowledged that sand is a good in derived demand, yet conversely, cheaper transportation was not always recognised as a supply factor.

Unexplained diagrams represent application of economics to the given context. However, once it is explained and used correctly in the answer it forms part of the analysis, the chain of reasoning, and contributes more effectively to the response.

Question 4

Students needed to use the extracts and their knowledge to assess the view that the increasing scarcity of sand was a problem best solved by market forces, rather than through government intervention. The better answers began with a discussion of the market mechanism, and an explanation of how rising prices due to scarcity would encourage the development and use of substitutes, such as 'mud, straw and wood'. They provided evidence of where this was already helping to solve the problem. It would have been good to see more discussion on this, and in greater detail. Students seemed to be much more comfortable discussing the role of governments and types of government intervention. Some focused excessively on policies, for example, those used to deal with negative externalities created in the extraction of sand, even to the extent of concluding which was the best policy option. In these cases, whilst the knowledge and analysis might have been reasonable/good, the evaluation was often more limited in terms of answering the question set.

Given that, for most students, sand was a completely unfamiliar context, most recognised the need to use the data in the extracts as part of their application skills. In the better answers the data prompts were effectively integrated with the theoretical analysis. This helped to bring the theory to life, and was used to support valid and appropriate conclusions. In this context, this included an appreciation of the international nature of the problem as explicitly alluded to in the extracts. Some answers were purely theoretical without dealing with the context.

In the strongest answers, students demonstrated their evaluation skills throughout the response, for example by making judgements on the significance and importance of arguments as they progressed, before coming to their final judgement. In order to achieve a level 5 response with these questions, the evaluation should be supported by theoretical analysis and also by the use of data from the extracts (if applicable) and the students' own examples and contexts.

Context 2

Question 5

Students were required to calculate the amount of government funding per £ of passenger income in the UK rail industry for a particular year, to the nearest penny. The majority earned 2 marks. Some used the incorrect figures from the table, but the most significant reason for no marks was a calculation where the numerator and denominator were interchanged. However, as with question 1, if students did use the correct method they were awarded 1 mark. A mark was also available for a correct answer that was incorrectly rounded and/or without units (£ or pence (p)).

Question 6

Students needed to explain how the data showed that changes in the demand for rail travel contributed to changes in the price of rail travel, over a given period of time. The data showed the indices of UK rail ticket prices and passenger kilometres. As with question 2, whilst definitions are not essential, they help to support the explanations. Some students defined 'market mechanism', or aspects of it, to help explain the link between rising demand and price. Many explained the link between changes in the index of passenger kilometres travelled and the demand for rail travel. Some students did not recognise that the data was in index number form, and/or read the data inaccurately from the graph. Explanations about how the data provided evidence were sometimes unclear or limited. In the best answers, in addition to a definition or brief explanation, students said what they expected to find to address the question, quoted accurate evidence from the data and then tied the answer up by saying how this evidence explained what had been asked for.

Question 7

In this question, students needed to use a diagram to help them explain why breaking up a natural monopoly in rail may affect long-run average costs. It was expected that students would use a long-run average cost curve diagram which showed two levels of output. One where the industry was operating as a monopoly, exploiting the available economies of scale, showing high output and low average costs, and a second which showed lower output and higher average costs. This was intended to represent one of the smaller firms in the market after the breaking up of the monopoly. Alternative diagrams were often drawn and were acceptable if supported by a logical chain of reasoning.

More effective responses tended to start with an accurate definition. They then went on to apply this well to the rail industry and from this point they were able to use the diagram to help explain the effect on long-run average costs using well-focused, logical analysis. However, many focused too much on the monopoly itself and strayed onto all sorts of other irrelevant aspects such as profit maximisation, allocative inefficiency and the impact on prices and consumer surplus. Consequently, even though the students' knowledge of economics might have been sound, their application of it was only reasonable or even limited. Some over-complicated the situation by trying to justify a different positioning of the LRAC curve, often showing the same quantity before and after, missing the point of the breaking up of the monopoly. Some answers were entirely theoretical and made no reference to the context of rail.

In contrast to the anticipated response, some students argued successfully that the breaking up of the monopoly might '…unleash efficiencies' as suggested in the extracts, and lead to lower long-run average costs. This line of analysis was rewarded accordingly.

It was disappointing to see some elementary mistakes on diagrams. In this case, for example, students often labelled the vertical axis of a cost curve diagram with 'price'.

Question 8

In this question students needed to use the extracts and their knowledge to evaluate the case for renationalising railways in the UK. Many students were able to make effective use of the prompts in the data to build up the case for and against renationalisation of the railways. Some students were clearly well prepared for this question, perhaps due to its high profile in recent years, and were able to make use of their additional knowledge of the situation. However, some of these responses tended to be more generic, and ignored the specific issues raised in the data. As an

example, a 'generic' drawback of renationalisation might be the huge costs to the government initially, yet the data referred to the '…low up-front costs: by taking over operations as franchises expire…'. This obviously posed a different viewpoint, and set apart those who made use of the data.

Some responses introduced elements of theory which though correct, was not well applied to the context. They suggested that the current structure approximated to perfect competition, and that a renationalised monopoly would likely operate at the profit maximising level of output, with higher prices and allocative inefficiency. In addition, despite the focus of question 7, many missed the opportunity to discuss the benefits of a natural monopoly which would be the likely result of renationalisation.

The most effective answers, drew from the evidence in the extracts, often accompanied by relevant examples and contexts and skilfully integrated this with theoretical analysis, before drawing supported, sensible conclusions.

Essay 1

Question 9

In this question students needed to explain how rules of thumb and irrationality could affect consumers' demand for goods and services. Many began with an explanation of the terms, using a variety of relevant terminology and provided a range of examples and appropriate contexts often from their everyday lives. It was the least popular of the essay questions, and it was attempted by some students who unfortunately had a lack of understanding in this area of the specification.

Question 10

In this question, students were required to assess the usefulness of behavioural economic theory compared to traditional economic policies in helping governments to correct market failures, and they were required to use examples to illustrate their answer. As with question 9, this really did provide students with a blank canvas as they could choose to write about any market failures.

A typical approach was to suggest a market failure, such as the negative consumption externalities arising from smoking, and consider how a traditional policy such as indirect taxation would work, and then compare it to a behavioural approach, such as nudging. In the stronger responses, in for example the context of cigarettes, students went on to explain how an awareness of behavioural theory might enhance the success of, say, indirect taxation, through changing social norms in relation to smoking. This helped to provide well-supported evaluation, whereas some students might have treated the two approaches in isolation, leading to much more superficial evaluation.

Generally, the answers were stronger on traditional policies, particularly where students used diagrams to support their written analysis. Many went through well-rehearsed pros and cons for indirect taxes, for example. In terms of behavioural approaches, some strayed onto what businesses might do rather than focus on government policies.

Some students rightly suggested that in terms of certain market failures, such as with public goods, a traditional approach might be the only solution, and generally acknowledged that different approaches might be appropriate for different market failures. Others considered the lesser or greater likelihood of government failure as a result of the influence of behavioural theory. However, this was more likely then given superficial attention rather than developing the chain of analysis further in a meaningful way.

Essay 2

Question 11

This question required students to explain the factors a profit-maximising firm would take into account when deciding whether to shut down or to carry on operating, both in the short run and the long run. There were a number of different approaches to this question, all capable of achieving full marks. Some responses adopted a very theoretical approach which often incorporated at least one diagram. They began with definitions of short run, long run and various types of costs, and then analysed the need to cover variable costs in the short run and total costs in the long run, although, not all of them explained why this was necessary.

Others drew from the prompts in the question. They considered factors such as the desire to build up market share like Spotify, or the nature of barriers to exit facing firms like House of Fraser. Alternatively, some analysed the current versus future state of the economy or market, the desire to be dynamically efficient, or the ability to become more productively efficient.

Whichever factor(s) were considered, in all cases the responses were enhanced by examples and contexts, which helped to bring the theory to life.

Question 12

Students needed to discuss the validity of the traditional economic assumption that the main objective of firms is to maximise profits. Higher scoring responses often started with a definition of profit and/or a distinction between normal and supernormal profit, followed by reasons why profit was important, to set the scene for profit maximisation. It became clear however, that a number mistook profit maximisation for 'high' profits, rather than the point at which marginal revenue is equal to marginal cost. Consequently, the misconception followed that the objective was only achievable in a market where firms had monopoly power. Typically, responses discussed a range of alternative objectives, such as sales or revenue maximisation, profit satisficing (often linked to the divorce between ownership and control) and non-financial motives such as corporate social responsibility or environmental goals. Many made effective use of diagrams to support their theoretical analysis and developed logical chains of reasoning. As part of their evaluation, a significant number considered whether these alternative approaches may be a route in the short run to achieve profit maximisation in the long run. Some distinguished between public and private sector firms, and/or charities, and as always the best answers were illustrated by examples and contexts. A few recognised the difficulties of calculating marginal revenue and marginal cost. However, most concluded that although firms often had many objectives, maximising profits was probably the main one.

Essay 3

Question 13

In this question students needed to explain how the impact of a minimum price for a good or service is affected by its price elasticity of demand and its price elasticity of supply. It was expected that the starting point would have been to define minimum price and both elasticities, and then move on to logically analyse the impact of elastic/inelastic PED and PES. Few responses defined the key terms, and even fewer considered the impact of the alternative possible outcomes. Many were able to give an example of a situation where a minimum price might be used, the most common being the recent minimum price for alcohol in Scotland. However, some answers strayed too far into market failure theory which was not relevant in this case. Where the determinants of PED and PES were considered, answers tended to have a better grasp of the former rather than

the latter. Many drew diagrams, though these were of variable quality, and some used them much more effectively than others to support their analysis. Some did not refer to them at all. A common error on the diagrams was to incorrectly identify the extent of excess supply; however, some did not even acknowledge that this was created.

Question 14

Students needed to discuss the view that a national minimum wage (NMW) is beneficial for an economy. They seemed much more at ease with this part of the essay, and many confidently identified the benefits and drawbacks of a NMW, and most were able to draw a reasonably accurate diagram. Higher scoring answers developed much deeper analysis, and often analysed the impact on imperfectly competitive labour markets in addition to perfectly competitive labour markets. Some responses recognised the role of a NMW in helping reduce the inequality gap and help solve the market failure; others often linked their findings to the economy as a whole. As always, the strongest responses were enriched by the examples, contexts and ideas, and it was pleasing to read some sophisticated lines of analysis and evaluation.

Use of statistics

Statistics used in this report may be taken from incomplete processing data. However, this data still gives a true account on how students have performed for each question.

Mark Ranges and Award of Grades

Grade boundaries and cumulative percentage grades are available on the Results Statistics page of the AQA Website.