Douglas County High School

IB ECONOMICS - INTERNAL ASSESSMENT COMMENTARY COVER

Name	Sample O. Student
Candidate Number	0001 - 0001
Teacher	John Cunningham
Source of the Article	Mirror Online
Title of the Article	Ed Millibrand energy play boost: Other EU countries already have Charges capped
Date of Article	20 May 2019
Date Written	01 January 2020
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Area of the syllabus your commentary relates to (please tick the one which is most relevant)	☐ Section 1: Introduction to economics ☒ Section 2: Microeconomics ☐ Section 3: Macroeconomics ☐ Section 4: International economics ☐ Section 5: Development economics

Checklist for handing work in				
Work is in the right order	The source of article is unique for your portfolio	Diagrams are included	It is within the word count	This work was produced individually and any information from other sources is properly referenced.
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Ed Miliband energy plan boost: Other EU countries already have charges capped

Sunday Mirror investigation shatters claims that UK power giants would be crippled if forced to freeze prices

Stephen Hayward

Load of hot air: Opposition criticisms don't stand up (Image: PA)

ED Miliband's pledge to freeze energy bills was boosted yesterday as it was revealed that more than half of EU countries already have similar price caps.

A Sunday Mirror investigation shatters claims that UK power giants would be crippled if forced to curb charges.

Hard-pressed families in France, Spain, Belgium, Denmark, Greece, Italy and Portugal are already protected from inflation-busting hikes in their bills.

Industry bosses and investors insisted the Labour leader’s plan will hit profits and investment and could lead to blackouts.

But figures from the Council for European Energy Regulators show 15 of the EU’s 28 member countries have regulated their markets since the 1990s to protect domestic and business customers from steep price rises.

Gas bills in Britain have soared by 41 per cent and electricity by 20 per cent since 2007.

Meanwhile the Big Six power firms – British Gas, SSE, Scottish Power, Eon, npower and EDF – raked in profits totalling more than £10billion.

More hefty price rises are expected this autumn.

But while EDF of France and Spanish-owned Scottish Power hammer UK customers with above-inflation hikes, similar rises are banned in their own countries. In France, prices fit an index-linked formula. This year partially state-owned EDF was allowed to raise energy prices by just five per cent with the same next year.

Bills in Spain are based on the market rate and a figure fixed by the government.

Spanish suppliers, including Scottish Power’s owner Iberdrola, have permission for a 5.4 per cent rise this year, adding £32 to bills.

Other countries peg prices to inflation rates. UK customers pay the fourth highest for electricity in Europe and seventh highest for gas – although the overall cost to the consumer is 12th and 14th as we have one of the lowest taxes on energy. But prices are rising faster than any other EU country.

Mr Miliband’s proposed 20-month freeze, announced at last week’s Labour conference, would save homes an average £120 and businesses £1,800.

Shadow Energy Secretary Caroline Flint said: “The fact most of Europe already has caps shows warnings about blackouts are just scaremongering.”

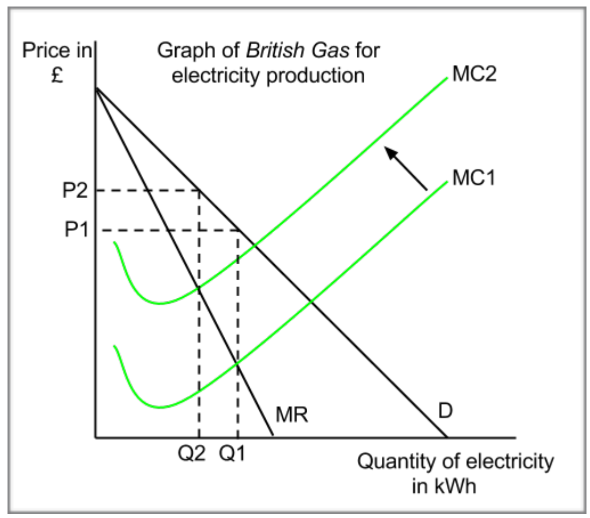
Mark Todd, of price comparison website energyhelpline.com, said: “Ed Miliband’s plan needs a bit of tweaking but could be a big step in the right direction.”

But the European Commission would prefer “targeted support for the elderly and vulnerable.”

Example Microeconomics Commentary

This article is about Ed Miliband's proposal to freeze prices for energy. Six market giants are complaining that this will make the profits fall and could lead to blackouts. A market with such competition level is an oligopoly. As it consists of six large firms, they are interdependent: firms have to consider actions and reactions of their competitors. Products in an oligopoly are normally (however, not in electricity market) differentiated. Finally, there are rather high barriers to entry.

The article states that prices in the UK for electricity have been rising the quickest in Europe. Reasons are not mentioned but there could be a few possibilities. Firstly, there is a chance that every firm's production costs have been increasing. Consider the diagram (for simplicity, a monopoly diagram is used):

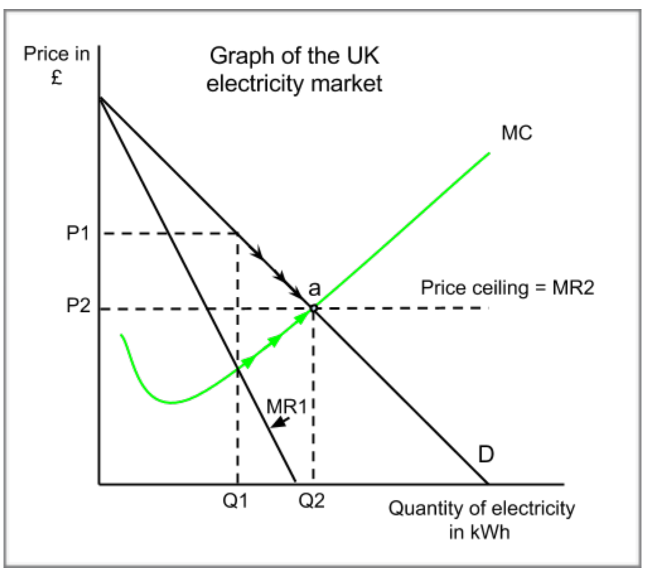


Assume *British Gas* is producing quantity Q1 where MC1=MR and none of the Big Six are colluding formally or informally. An increase in firm's production costs means an increase in its marginal costs (MC1-MC2) which are additional costs of producing one more unit of output. After the increase *British Gas* starts producing Q2 at its profit maximising point where MC2=MR and price increases P1-P2. It is likely that this will happen to other firms in the market as well, because there is no obvious reason for having only one firm's costs increasing.

Economic concept of "sticky prices" states that firms in such situations should not change the price. It suggests that if a firm increases the price, competitors will not follow and that firm will lose revenue as consumers will migrate to another supplier. However, in the electricity market consumers sign fixed-term contracts with suppliers. Sometimes in order to terminate a contract a fine must be paid. These possible complications2 allow suppliers to increase the price virtually without losing clients. People facing difficulties changing the producer are more likely to pay the extra cost. After a firm notices that competitors have increased prices and consumers did not migrate, it starts to charge more as well. So the prices in electricity market might be increasing due to increasing production costs.

If firms' costs really are increasing, price ceiling which is the maximum price the producer can charge, might actually hit profits and possibly lead to blackouts. In this case, firms are increasing charges in order to keep abnormal profit maximum. If after the maximum price is introduced the production costs keep increasing, eventually abnormal profits might disappear at all. This could be the reason why firms state that price freeze "<…> will hit investment". If costs increase above the price ceiling, firms might start making a loss: "<…> could lead to blackouts". However, this is unlikely to happen as "UK customers pay the 4th highest for electricity <…> although the overall cost to the consumer is 12th". So in other countries consumers pay less even though the costs of production are higher. If so, then Miliband's plan would probably work as desired: it would lower firms' abnormal profits and offer lower prices for a necessity.

Another reason for rising prices could be the decision of the *Big Six* to informally collude. If so, the idea to cap prices would not only stop that but also benefit the consumer. Consider the diagram:



The market starts in equilibrium at Q1 where MC=MR1 and P1. The government sets the price P2. P2aD becomes the new demand curve for electricity. Maximum price (P2) becomes firms' marginal revenue (MR2) which is the additional revenue from the sale of an additional unit. Normally, price ceiling would cause supply to contract. However, in this situation as firms always produce at profit maximising point MC=MR2 supply and demand extend Q1->Q2. Also, because at quantity Q2, P2=MC, electricity market becomes allocatively efficient. It means that resources are allocated in the way that quantity of good produced is the quantity preferred by the customers.

If the speculation that the *Big Six* are colluding to fix prices is correct, Miliband's price ceiling might be a good solution. Firstly, it should stop oligopolies from colluding as they would not have the possibility to increase charges. Secondly, consumers would be protected from oligopolies exploiting their power and putting up the prices. Thirdly, the market would be allocatively efficient. That means that there would be no deadweight welfare loss – loss of social surplus. However, price freeze might lower firms' abnormal profits. That could negatively affect investments in research and development possibly deterring improvements in efficiency.

Student Name				
Section		**Date**		**Marks**
Word count				

	A. Diagrams	**B. Terminology**	**C. Application**	**D. Analysis**	**E. Evaluation**
0	The work does not reach a standard described by the descriptors below.	The work does not reach a standard described by the descriptors below.	The work does not reach a standard described by the descriptors below.	The work does not reach a standard described by the descriptors below.	The work does not reach a standard described by the descriptors below.
1	Relevant diagrams are included but not explained, or the explanations are incorrect.	Terminology relevant to the article is included in the commentary.	Relevant economic concepts and/or theories are applied to the article.	There is limited economic analysis relating to the article.	Judgments are made that are unsupported, or supported, by incorrect reasoning.
2	Relevant, accurate and correctly labelled diagrams are included, with a limited explanation.	Terminology relevant to the article is used appropriately throughout the commentary.	Relevant economic concepts and/or theories are applied to the article appropriately throughout the commentary.	There is appropriate economic analysis relating to the article.	Judgments are made that are supported by limited reasoning.
3	Relevant, accurate and correctly labelled diagrams are included, with a full explanation.			There is effective economic analysis relating to the article.	Judgments are made that are supported by appropriate reasoning.
4					Judgments are made that are supported by effective and balanced reasoning.

Commentaries: