ECONOMICS

Higher level PAPER \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Question 1

**(a) Explain the factors which might influence the cross price elasticity of demand between different products. *[10 marks]***

Answers **may** include:

 \_definitions of cross price elasticity of demand

 \_theory to include explanation of formula, significance of positive and negative coefficient of cross price elasticity. Emphasis is likely to be on complements and substitutes.

 \_diagrams to show markets where the change in price of one good influences demand for another good positively (substitutes) or negatively (complements)

 \_examples of substitutes, complements and unrelated goods.

**(b) Examine the importance of income elasticity of demand for the producers of primary products, manufactured goods and services. *[15 marks]***

***N.B.*** It should be noted that definitions, theory and examples that have already been given in part (a), and then referred to in part (b), should be rewarded.

Answers **may** include:

 \_definitions of income elasticity of demand, primary products

 \_theory of the importance of income elasticity for producers of primary products, manufactured goods and services

 \_diagrams to show the effect of differing coefficients of income elasticity of demand

 \_examples of different types of primary products, manufactured goods and services

 \_synthesis and evaluation (examine).

Examination **may** include: knowledge that a change in income will have differing effects on the three types of products specified in the question necessitating different strategies for the producers of these products, for example, diversification, value added.

Examiners should be aware that candidates may take a different approach which, if appropriate, should be rewarded.

Opinions or conclusions should be presented clearly and should be supported by appropriate examples.

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**Examiners Report**

(a) This was probably the question that candidates found most difficult and it was the least popular. A significant number of candidates confused cross price elasticity with price elasticity of demand. The question was about complements and substitutes and the degree to which goods were related. Good candidates were able to easily apply appropriate theory and provide suitable examples. Examples are more emphasised by the new programme but, particularly in microeconomics, they are as likely to take the form of theoretical examples developed by the candidate as they are to take the form of real world examples that might be more suitable when discussing macroeconomic policy.

(b) Many candidates struggled to identify the importance of YED for producers. Those that could provide an explanation of what YED was and who could relate to different markets as indicated by the question tended to score well. The basic point was that candidates were expected to be able to identify what the impact on sales might be of changes in income. Good candidates were able to use the concept of normal and inferior goods and services to develop a line of reasoning relating to how firms might have to alter output or change what they supply as incomes change.

**Question 2**

**2. (a) Distinguish between the concepts of income elasticity of demand (YED) and cross price elasticity of demand (XED). *[10 marks]***

Answers **may** include:

• \_definitions of YED and XED. Formula q/ money value

• \_diagrams to illustrate YED ( y axis income and x axis quantity demanded.and XED (y axis price and x axis quantity demanded. Better to show diagrams for both goods e.g 2 complementary or substitute goods)

• \_an explanation of the features of YED and XED and how they differ in terms of calculation and interpretation

• \_examples of goods with different YED eg. Luxury goods vs food items and XED competitive (Coca Cola and Pepsi).

**(b) To what extent might the concepts of YED and XED be of significance for business organizations? *[15 marks]***

***N.B.*** It should be noted that definitions, theory, and examples that have already been given in part (a), and then referred to in part (b) should be rewarded.

Answers **may** include:

• \_diagrams which may be relevant to the discussion

**YED**

* an explanation of the relevance of YED for business organizations in terms of normal goods/inferior goods and primary goods/manufactured goods/services; If yed is positive elastic then firm will benefit from increases in income e.g. if yed = + 5.0 then the firm will be better off in terms of demand than a firm that has a yed of + 0.4 or a firm that has a yed of -2.0
* primary goods will tend to be income inelastic and manufactured/services more elastic

**XED**

explanation of the relevance of XED for business organizations in terms of changes in prices of substitute and complements

* highlights importance for firms of competitive pricing in terms of substitute goods and interdependence for complementary goods

• \_examples of use of the concepts in practice

• \_synthesis or evaluation (to what extent).

Command term

“To what extent” requires candidates to consider the merits or otherwise of an argument or concept.

Consideration of the merits of the concepts **may** include: the relative importance of the two concepts and the difficulties of obtaining an accurate measure of each in reality.

Examiners should be aware that candidates may take a different approach which, if appropriate, should be rewarded.

Opinions or conclusions should be presented clearly and should be supported by appropriate examples.

**Examiner’s Report**

(a) There were some mixed responses to this question. Elasticity is quite a technical aspect of the guide and if you do not know the material well they will make mistakes. The highest achieving candidates clearly explained the differences between YED and XED and how they are interpreted. Lower achieving candidates made numerous mistakes. This question requires examples and it was good to see the highest achieving candidates using real world examples to support their answers. Candidates often found it difficult to include a diagram to answer this question. For complementary goods with a negative XED, a demand and supply diagram was an effective method of showing how, for example, a fall in the price of broadband might shift the demand for laptop computers to the right.

(b) Candidates found this question difficult and struggled to explain how YED and XED are of significance to businesses. It was common to see answers that simply said a rise in income would lead to a rise in the demand for a normal good and firms that sell normal goods could then increase their prices as a result of this. It would be better to say how, for example, a company like Apple that markets a normal good like the iPhone would export more iPhones to markets in developing countries as incomes are forecasted to grow in the future. Candidates also found it difficult to evaluate their answers to this question. An effective approach here could be to consider how YED and XED vary over time and across different areas in a country, which makes it difficult to predict exactly how the demand for products will change when incomes and the price of related goods change.